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

INCOME TAX APPEAL NO. 1671 OF 2012
WITH
INCOME TAX APPEAL NO. 4 OF 2013
WITH
INCOME TAX APPEAL NO. 72 OF 2013

Commissioner of Income Tax – 12 } Appellant
versus
M/s. DRM Enterprises } Respondent

Mr. P. C. Chhotaray for the Appellant.
Ms. Aarti Sathe for the Respondent.

CORAM :- S.C.DHARMADHIKARI &
A.A.SAYED, JJ.
DATED :- DECEMBER 11, 2014

P.C. :-

These Appeals of the Revenue question the correctness of the view taken by the Tribunal in its order dated 16th May, 2012 for the assessment years 2000-01 to 2002-03.

2) The brief facts in the backdrop of which a substantial question of law would arise for consideration and determination of this Court, according to the Revenue, are that the Assessee filed its return of income declaring total income of Rs.5,98,181/- on 30th October, 2000. The Assessee carries on business as Transport Contractors, Crane Operators, Crane Hiring, Forklift Hiring and Trailers Hiring etc. The

Assessee follows the method of cash system of accounting. The original account was completed on a total income of Rs.28,05,930/-. The main addition to the total income was on account of unexplained expenditure under section 69C of the Income Tax Act, 1961 (for short "the IT Act") at Rs.21,60,000/-. The matter went up to the level of Income Tax Appellate Tribunal (ITAT) and it passed order on 6th December, 2006 restoring the issue of addition of Rs.21,60,000/- to the file of the Assessing Officer. In the meanwhile, the Assessing Officer, on receiving certain audit objections, proposed to reopen the assessments under section 148 of the IT Act and after receiving an approval from the Commissioner of Income Tax-12, Mumbai, the assessments were reopened. Since the ITAT restored the addition made under section 69C of the IT Act for re-verification, the Assessing Officer merged the reopening with the directions of the ITAT. A notice under section 148 of the IT Act was issued and served upon the Assessee, in response to which, return of income was filed on 29th November, 2006. This was objected to on the ground that all the points raised by the audit party were considered at the first assessment stage itself. The Assessee contended that it had filed detailed explanation in relation to the expenditure and also furnished all details. The Assessing Officer, after examining the records and the documents filed by the Assessee, allowed the expenses as revenue expenditure and merely because the audit party has raised objections in relation to the allowability of the expenditure, the assessment cannot be reopened on the basis of change of opinion. Additionally, it was contended that the Assessing Officer has not recorded his independent satisfaction. That is how the process is vitiated in law. However, an order was passed by the Assessing Officer rejecting these submissions on 28th May, 2007. An Appeal was preferred by the Assessee to the Commissioner of Income Tax (Appeals), which was dismissed on 30th March, 2010 confirming the additions made by the Assessing Officer. That is how the matter was carried in Appeal to the Tribunal by the Assessee.

3) In allowing the Appeal of the Assessee, the Tribunal concluded that there is much substance in the contention of Assessee's representative. The departmental representative could not produce the reasons recorded for reopening the assessment and opportunity was given to the departmental representative by the Tribunal to produce these reasons or a copy of thereof. However, beyond producing a copy of the letter written by the Assessing Officer to the Commissioner of Income Tax seeking permission for reopening the assessment, nothing was produced by the departmental representative. The Tribunal concluded that, in this letter, the notings of the Senior Audit Officer are mentioned. The audit party had questioned the allowance of

depreciation and allowance of repairs on spare parts as revenue expenditure. The audit objection in relation to excess allowance of depreciation has been rejected by the Assessing Officer. The Assessing Officer has reopened the assessment only on the objection raised for the allowance of expenses as revenue expenditure, which, according to the audit party, ought to have been treated as capital expenditure. The Tribunal, in para 7 of its order, held thus:

> "7. We have heard the rival submissions and perused the orders of lower authorities. We find force in the contention of Ld. AR that the AO has simply followed the objections raised by audit party. The AO has initially given his own reason in the body of assessment order. On the contrary, the AO in the assessment has mentioned that the assessment was reopened with the prior approval of Ld. CIT(A) on the objections raised by the audit. We find that the assessment made u/s. 143(3) r.w.s. 147 is devoid of any application of mind on the part of AO. We therefore reverse the finding of Ld. CIT(A) and hold that AO has no reason to believe that income has escaped assessment or the assessee has filed inaccurate particulars of income as no new facts are brought on record. All the expenses claimed by the assessee have been verified in detail in the original assessment therefore the reopening of assessment to disallow the same merely on the basis of audit report is not justifiable. Therefore, ground 1 is allowed."

4) Mr. Chhotaray appearing for the Revenue submits that the substantial question of law is "whether the Tribunal was justified in questioning the reassessment because the reasons therefor have not been assigned and independent of the audit objections". Mr. Chhotaray endeavors to submit that the objections raised by the audit party are enough and to undertake the exercise as undertaken by the Assessing Officer. In that he relied upon a Judgment of the Hon'ble Supreme

Court in the case of *Commissioner of Income Tax vs. P. V. S. Beedies Pvt.Ltd.* reported in ***(1999) 237) ITR 13***. He also relied upon an earlier Judgment in the case of *Kalyanji Mavji and Co. vs. Commissioner of Income Tax, West Bengal II* reported in **(1976) 102 ITR 287.**

5) Ms. Sathe appearing for the Assessee, on the other hand, submits that the Appeal does not raise any substantial question of law. She submits that the audit party objections could form the basis for reopening of the assessment is what is urged before the Tribunal and before us by the Revenue. However, that alone would not suffice. The requirement of recording independent satisfaction and reasons therefor by the Assessing Officer is necessary. The basis for reopening the assessment could be the audit objections, but the requirement of reasons and satisfaction for reopening the assessment cannot be said to be in any way dispensed with. That is the conclusion reached by the Tribunal. Further, the factual conclusion reached is that the audit party raised two objections, one of which was rejected by the Assessing Officer. He relied only on the second objection. If he had omitted from consideration and rather rejected one objection of the audit party, that means the Assessing Officer was aware of the fact that he is required to record reasons and his independent satisfaction. The Tribunal, in interfering with such an order of the Assessing Officer, has not

committed any error of law, much less acted perversely. Ms. Sathe would rely upon two Judgments, one rendered by the Hon'ble Supreme Court in the case of *Indian and Eastern Newspaper Society vs. Commissioner of Income Tax, New Delhi* reported in ***(1979) 119 ITR 996*** and a Division Bench Judgment of this Court in the case of *Purity Techtextile Private Limited vs. Assistant Commissioner of Income Tax and Anr.* reported in ***(2010) 325 ITR 459***. She also relied upon two Judgments rendered by the Gujarat High Court and one by a Division Bench of Delhi High Court, all of which have been rendered recently. She therefore submits that the Appeal be dismissed as it does not raise any substantial question of law.

6) With the assistance of Mr. Chhotaray and Ms. Sathe, we have perused the memo of Appeal and all annexures thereto. We have perused the impugned order and the relevant provisions and decisions brought to our notice. There is no necessity to repeat the facts. The correctness of the conclusion of the Tribunal, as recorded in para 7 and reproduced above is under issue. The Hon'ble Supreme Court in the case of *P. V. S. Beedies Pvt. Ltd.* (supra), relied upon by Mr. Chhotaray, held that the internal audit party merely pointed out a fact which had been overlooked by the Income Tax Officer in the assessment. The Income Tax Officer did not notice that recognition granted to the

charitable trust had expired on 22nd September, 1972. This was not a case of information on a question of law. The internal audit party was entitled to point out a factual error or omission in the assessment. The reopening of a case on the basis of factual error pointed out by the audit party was permissible under law. In recording that conclusion, the Supreme Court held as under:

> "1. These cases relate to Assessment Years 1974-75 and 1975-76. The relevant accounting years ended on 31-3-1974 and 31-3-1975 respectively. Originally the assessment was completed on 21-6-1977. There were various other proceedings which ended in the Tribunal. The Tribunal after considering all aspects of the cases remanded the cases back to the Income Tax Officer for passing a fresh order in accordance with law. One of the points raised before the Income Tax Officer was that of justification for reopening of the assessment. It was pointed out that reopening has been done on the basis of the report made by the Audit Department. The contention which found favour with the Tribunal was that reopening under Section 147(b) is not permissible on the basis of a report given by the Audit Department. This view was also taken by the High Court.
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> 2. We have considered the matter. It appears that the reopening was done because in the original assessment donations made to a body known as P.V.S. Memorial Charitable Trust was held by the Income Tax Officer to be eligible for deduction under Section 80G. But subsequently it was pointed out by the internal audit party that the recognition which had been granted to the P.V.S. Memorial Charitable Trust had expired on 22-9-1972. That means it had expired before 1-4-1973. Therefore, in the relevant years of account this Trust was not a recognised charitable trust. In that view of the matter the donation to P.V.S. Memorial Charitable Trust did not qualify for deduction under Section 80G as a donation made to a recognised charity.
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> 3. We are of the view that both the Tribunal and the High Court were in error in holding that the information given by internal audit party could not be treated as information within the meaning of Section 147(b) of the Income Tax Act. The audit party has merely pointed out a fact which has been overlooked

by the Income Tax Officer in the assessment. The fact that the recognition granted to this charitable trust had expired on 22-9-1992 was not noticed by the Income Tax Officer. This is not a case of information on a question of law. The dispute as to whether reopening is permissible after audit party expresses an opinion on a question of law is now being considered by a larger Bench of this Court. There can be no dispute that the audit party is entitled to point out a factual error or omission in the assessment. Reopening of the case on the basis of a factual error pointed out by the audit party is permissible under law. In view of that we hold that reopening of the case under Section 147(b) in the facts of this case was on the basis of factual information given by the internal audit party and was valid in law. The judgment under appeal is set aside to this extent.

4. The appeals are allowed. There will be no order as to costs."

7) In the earlier decision, which was rendered in the case of *Kalyanji Mavji and Co. vs. Commissioner of Income Tax* (supra), the Hon'ble Supreme Court found that the reassessment was valid as held by the High Court because the information on the basis of which the Income Tax Officer sought to reopen the assessment was based on subsequent facts as also on the materials of the original assessment proceedings. The decision was confirmed by the Hon'ble Supreme Court and it laid down certain principles.

8) However, the notice and which has to be issued in terms of the legal provision, namely, section 148 of the IT Act and the satisfaction that is required to be recorded therein was not in issue in the decisions relied upon by Mr. Chhotaray. Section 147 of the IT Act enables the Assessing Officer to record his reasons and for a belief that

any income chargeable to tax has escaped assessment for any year, he may subject to the provisions of section 148 and 153 of the IT Act, assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recommpute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned. We are not concerned with the proviso in this case and the *Explanations* which have been inserted in section 147. What is required by law further is issuance of notice, where income has escaped assessment. That is a provision and to be found in section 148. Sub-section (1) thereof states that before making the assessment, reassessment or recomputation under section 147, the Assessing Officer shall serve on the Assessee a notice requiring him to furnish within such period as may be specified in the notice, a return of his income or the income of any other person in respect of which is he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and the provisions of this Act shall, so far as may be, apply. Sub-section (2) thereof requires the Assessing Officer to record his reasons before issuing notice under section 148(1).

9) The Tribunal found in this case and as a matter of fact that the departmental representative, despite opportunity being given, could not produce a copy of the reasons from the file and which have been recorded by the Assessing Officer. Rather, the Tribunal proceeded on the footing that there were no reasons recorded. Despite seeking an adjournment from us, Mr. Chhotaray was unable to produce the reasons for issuance of notice nor produced any material recording the belief, which must be preceding the initiation of the action. The Tribunal proceeded to then consider the correctness of the submission of the departmental representative that compliance under section 148 was made in this case and by relying on the audit report. The audit objections could form the basis for initiation of the proceedings was the Department's stand and further that reasons are recorded in the letter which has been addressed by the Assessing Officer to the Commissioner. This was therefore a sufficient compliance with the statutory mandate. The Tribunal disagreed with the departmental representative and held that the Assessing Officer merely followed the objections raised by the audit party. The assessment was reopened with prior approval of the Commissioner on the objections raised by the audit party. There was no application of mind by the Assessing Officer. It is in these circumstances and when one of the objection of the audit party has been rejected by the Assessing Officer, that we find substance in the contention of Ms.

Sathe that the Tribunal did not commit any error of law apparent on the face of the record and in allowing the Assessee's Appeal. The reliance placed by Ms. Sathe on the Judgment of the Hon'ble Supreme Court in the case of *Indian and Eastern Newspaper Society* (supra) is therefore well-placed. The Hon'ble Supreme Court in that case found that the Assessing Officer/Income Tax Officer had before him a view of the internal audit party that the money realised by the Assessee on account of the occupation of its conference hall and rooms should not have been assessed as income from business. It should have been made under the head “income from property”. The Income Tax Officer treated the contents of the report as 'information' in his possession for the purpose of section 147(b) of the IT Act and reassessed the income on that basis. The ITAT noticed a conflict of judicial opinion on the question “whether the internal audit report could be treated as information for the purpose of section 147(b)” and therefore sought a reference. Thereafter, the Hon'ble Supreme Court held that an assessment proceeding is a quasi judicial proceeding. It acquires finality on the assessment order being made. The finality of such an order can be disturbed only in proceedings and within the confines, provided by law. An appeal, revision and rectification are proceedings in which the finality may be questioned. The provision enabling reassessment is then referred and which is peculiar, namely for assessing income which has escaped assessment. Then, the Hon'ble Supreme Court referred to as to what could be information and what material constitutes the same. The Hon'ble Supreme Court then referred to the status of an internal audit report and held as under:

> "In that view, therefore, when s. 147(b) of the I. T. 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, influences the course of the assessment and decides any one or more of those matters which determine the assessee's tax liability.
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> 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 organization 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 coextensive with that of Receipt Audit. The nature and scope of Receipt Audit are defined by s. 16 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971.
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> 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 s. 16 of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971. And para 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 recognized 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 reports the status of a declaration of law binding on the ITO. 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 I. T. Act does not contemplate such power in any internal audit organization of the income-tax department; it recognizes it in those authorities only which are specifically authorized to exercise adjudicatory functions. Nor does s. 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 objections 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 s. 147(b) of the I. T. Act, 1961.

But although an audit party does not possess the power to so pronounce on the law, it nevertheless may draw the attention of the ITO 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 s. 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."

10) There as well, an opinion was given by the audit party with regard to the receipts from the occupation of conference hall and rooms. The Hon'ble Supreme Court held that 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 not 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. It is his belief and the statutory exercise contemplated by section 147(1) and 148(2) must be carried out by him. That requirement is not dispensed with merely because he has before him the views of the audit party.

11) We do not see, how the Tribunal, in the case before us, while relying on such decision, erred in law in reversing the order of the Commissioner of Income Tax (Appeals). We do not multiply this Judgment with further decisions and cited by Ms. Sathe. Suffice it for our purpose that if an independent exercise expected to be undertaken by the Assessing Officer has not been undertaken, then, the Tribunal

was in no error in setting aside the proceedings that were initiated by him. The Tribunal has rightly held that once the audit party raised objections, one of which was not accepted, then, the Assessing Officer was expected and in the given facts and circumstances to record reasons for his belief. Those reasons have not been recorded, as is clear from the material placed before the Tribunal. Despite sufficient opportunity, the reasons for reopening the assessment having not been placed on record that the Tribunal held as above.

12) In the light of the above conclusions, we do not think that the Appeals raise any substantial question of law and particularly formulated by the Revenue. They are accordingly dismissed. There would be no order as to costs.

(A.A.SAYED, J.) **(S.C.DHARMADHIKARI, J.)**