IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O. O. C. J.

INCOME TAX REFERENCE NO.113 OF 1990

Grasim Industries Ltd. ...Applicant.
Vs.
Commissioner of Income Tax,Central-I. ...Respondent.

....

Mr. J.D.Mistry with Mr.Atul K. Jasani for the Applicant.
Mr. Abhay Ahuja with Mr.J.S.Saluja for the Respondent.

.....

CORAM : DR.D.Y.CHANDRACHUD AND
J.P.DEVADHAR, JJ.

February 1, 2010.

JUDGMENT (PER DR.D.Y.CHANDRACHUD, J.) :

By an order dated 8th August 1989, passed under Section 256(1) of the Income Tax Act, 1961, the Income Tax Appellate Tribunal has referred the following question of law for the opinion of this Court:

> "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in upholding the order of the Commissioner of Income Tax passed u/s.263 directing the Income-tax Officer to include the sum of Rs. 1,75,32,600/- in the total income of the assessee under Sec.41(1) of the Income Tax Act on the ground that there had been a complete cessation of liability in regard to this amount in the previous year relevant to the assessment year 1982-83?"

2. Pursuant to its policy to attract industrial investment in the State, the Government of Kerala granted a concession in 1958 to Gwalior Rayon Ltd (the earlier name of the assessee) to fell and remove bamboos from the Nilamber valley for conversion into rayon grade wood pulp. Agreements were entered into between the assessee and the Government of Kerala. The Company purchased three lakh acres of private forest and planted eucalyptus for use as raw material on an undertaking by the Government not to acquire the forest for a period of sixty years. In 1963, the Company set up a plant at Calicut for the manufacture of rayon grade wood pulp. The raw material required for the plant consisted of forest produce, namely, bamboo, reed and eucalyptus. The Government of Kerala agreed to provide any shortfall in the raw material from other areas. The rate of seigniorage was fixed at Re. 1 per ton. In 1971, private forests in the State of Kerala were nationalized by the Kerala Private Forests (Vesting and Assignment) Act, 1971. Upon the enforcement of the Act, there was no private forest in the State of Kerala and all forest produce had to be purchased from the Government alone. On 10th July 1971, an agreement was entered into between the Company and

the State Government for the supply of raw material, including eucalyptus at approximately Rs.23 per ton. The State Legislature enacted the Kerala Forest Produce (Fixation of Selling Price) Act, 1978, by which the Government was required by notification to fix the selling price of all forest produce (Section 3) and all forest produce was required to be sold at a price not less than the notified price (Section 5). The Government of Kerala issued a notification fixing prices of forest produce on 9th March 1979 and thereafter, for the period ending on 31st March 1981 and for the period commencing from 1st April 1981, being the previous year relevant to the Assessment Year 1982-83. The validity of these notifications was questioned by the Company in a Writ Petition filed before the Kerala High Court.

-3. The Company had been allowed a deduction of the following amounts, including interest, during the course of Assessment Years 1980-81, 1981-82 and 1982-83:

A.Y. 1980-81 (y/e 31.3.80)	93,89,183
A.Y. 1981-82 (y/e 31.3.81)	72,13,634
A.Y. 1982-83 (y/e 31.3.82)	9,29,783

	1,75,32,600

During the pendency of the Writ Petitions before the Kerala High Court, the Company had kept in force Bank Guarantees in the sum of Rs.201 lakhs together with interest at the rate of 6% per annum in respect of the enhanced liability under the notifications.

4. By a judgment dated 15th April 1981, a Division Bench of the Kerala High Court allowed the Petition filed by the Company and set aside the four notifications that were challenged, in so far as they related to the fixation of the selling price of eucalyptus. The High Court held that in fixing the selling price of eucalyptus, the statutory requirement of Sections 3 and 4 had not been complied with and that all materials that were required to be considered had not been placed before the Committee. The Kerala High Court held that the Committee had not looked into relevant matters for recommending the selling price of eucalyptus. The price fixed by the notifications for eucalyptus was, therefore, held to be ultra vires and to that extent, the notifications were quashed. The notifications were upheld for other forest produce.

5. After the judgment of the High Court, the State Government renotified prices/notifications with effect from 1st April 1981. In order to overcome the judgment of the High Court, the Kerala Forest Produce (Fixation of Selling Price) Rules, 1978 appear to have been amended on 28th May 1981.

6. The previous year relevant to the Assessment Year in question, namely 1982-83, ended on 31st March 1982. According to the Revenue, the result of the notifications, which had been issued by the State of Kerala in the first instance, was to saddle the assessee with an additional liability of Rs.1,75,32,600/- for three Assessment Years - 1980-81, 1981-82 and 1982-83. The claim in regard to these liabilities was allowed into the regular assessments on the basis of the provision made by the assessee. According to the Revenue, as a consequence of the judgment of the Kerala High Court, striking down the notifications, the liability of the assessee for the aforesaid three years, stood reduced by a corresponding amount. However, though the judgment of the High Court was delivered in the early part of the accounting year, relevant to Assessment Year 1982-83, the liabilities which ceased as a result of

the judgment, were not written back to the profit and loss account for the Assessment Year 1982-83. The amount was offered for taxation in the Assessment Year 1983-84.

7. On this basis, the Commissioner of Income Tax initiated proceedings under Section 263 of the Income Tax Act, 1961, by the issuance of a notice dated 15th December 1986. By an order dated 6th February 1987, the Commissioner of Income Tax held that the decision of the Kerala High Court, dated 15th April 1981, had attained finality since no appeal was filed before the Supreme Court. Consequently, the liability of the assessee was held to have ceased at the beginning of the accounting year, relevant to Assessment Year 1982-83 and since the Government had not filed an appeal against the judgment of the High Court, the liability had ceased finally and there was no possibility of it being revived in future. The liability having ceased in the accounting year relevant to Assessment Year 1982-83, the amount of Rs.1,75,32,600/- was assessable as income under Section 41(1) in Assessment Year 1982-83. The Assessing Officer was directed to revise the assessment for Assessment Year 1982-83 by including the amount

of Rs.1.75 crores in the total income of the assessee.

8. The order passed by the Commissioner of Income Tax under Section 263, was challenged in appeal before the Income Tax Appellate Tribunal. By its judgment dated 28th July 1988, the Tribunal dismissed the appeal. Before the Tribunal, it was urged on behalf of the assessee that the CIT had exceeded his jurisdiction under Section 263. Though the Kerala High Court had delivered its judgment on 15th April 1981, striking down the notifications under which the assessee was required to pay enhanced seigniorage charges, it was urged that it is wrong to assume that the liability had ceased no sooner than upon the passing of the judgment of the Kerala High Court. The assessee relied upon several circumstances, in order to buttress the submission that it had reason to believe bona fide that the State of Kerala was not inclined to accept the judgment of the High Court. To these circumstances, a reference would be made in a subsequent part of the present judgment. At this stage, it would be necessary to note that the Tribunal rejected the contention of the assessee that there was no remission or cessation of liability during the course of Assessment Year 1982-83.

The Tribunal held that the judgment of the High Court was in favour of the assessee and that the time prescribed for filing an appeal before the Supreme Court having expired, the liability had ceased during Assessment Year 1982-83. Since the amount was not offered for taxation during the Assessment Year 1982-83, but only subsequently in 1983-84, the Tribunal concurred with the view of the CIT.

9. On behalf of the assessee, it has been submitted that (i) The jurisdictional condition precedent to the application of Section 263 is that the order sought to be revised must be erroneous in so far as it is prejudicial to the interests of the Revenue and neither of these conditions is satisfied; (ii) The order of the Assessing Officer dated 23rd February 1985 was upon accepting the written contention of the assessee that the liability had not irrevocably ceased to exist by virtue of the judgment of the Kerala High Court. This was a possible view and when the view taken by the Assessing Officer is possible to be taken, such an order cannot be held to be erroneous or prejudicial to the interests of the Revenue so as to invoke the revisional jurisdiction under Section 263; (iii) In view of

various circumstances, which are relied upon by the assessee, the view of the assessee was a possible view and bona fide; (iv) There must be material before the CIT to hold that an order is "erroneous and prejudicial to the interests of the Revenue" and a mere change of opinion, cannot render the order erroneous. The CIT has not considered anything other than the order of the High Court dated 15th April 1981, which was considered by the Assessing Officer, who had taken a possible view of the matter; (v) The order passed by the CIT does not demonstrate any prejudice to the Revenue; (vi) The onus of establishing the jurisdictional condition precedent would lie on the Commissioner; (vii) The deeming fiction under Section 41(1)(a) can be applied only if there is an irrevocable cessation of the liability so that there is no possibility of a revival in future. In the present case, a part of the very liability for the period 1981-82 was still enforceable on 31st March 1982 and hence, Section 41(1) could not be invoked; (viii) This part of the liability was struck down by the Kerala High Court subsequently on 28th May 1984, against which a Special Leave Petition was filed before the Supreme Court. The Supreme Court granted leave on 10th October 1986 and passed an interim order directing the assessee to

pay seignorage charges at the rate of 60% of the charges fixed by the impugned notification. The actual rate was determined only finally in terms of an agreement dated 27th October 1988 between the Government of Kerala and the assessee, pursuant to which, the Civil Appeal and various pending matters were withdrawn. Consequently, there was no cessation of liability during the Assessment Year 1982-83 and the provisions of Section 41(1) could not be applied; (ix) In any event, there was a possibility of a revival of the liability having regard to various facts and circumstances; (x) In determining as to whether there was a cessation of liability, it was necessary to consider as to whether the liability could be revived. In the present case, the notifications were only instruments quantifying the liability and the liability *per se* had never ceased. Even if the notifications had been struck down, a renotification for the same period or an amendment of the law was always open to the State to enforce the enhanced liability; and (xi) The liability of the assessee arises as a result of the supply of forest produce. There was no dispute that such produce had been supplied by the Government and, therefore, the Company had to pay for it. The Kerala Forest Produce Act, 1978 acquired the

government to fix the minimum price for produce. The fact that a particular notification has been struck down, would not lead to the conclusion that the liability itself had ceased. All that followed, as a consequence of the striking down of the notifications, was that the price would have to be fixed afresh in accordance with law.

10. On the other hand, it was urged on behalf of the Revenue that the liability of the assessee under the notifications issued by the Government of Kerala, came to an end with the judgment of the High Court dated 15th April 1981. Even if fresh notifications were to be issued, that would amount to the imposition of a fresh liability upon the assessee. Consequently, during the period which is relevant to Assessment Year 1982-83, the liability had ceased to exist, the State Government having not filed any appeal before the Supreme Court within the prescribed period of limitation. The assessee was, therefore, duty bound to offer the amount for taxation in Assessment Year 1982-83, whereas the assessee had done so only in the following Assessment Year.

11. Section 263 of the Income Tax Act, 1961 empowers the

Commissioner to call for and examine the record of any proceedings under the Act and, if he considers that any order passed therein, by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the Revenue, to pass an order upon hearing the assessee and after an enquiry as is necessary, enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment. The key words that are used by Section 263 are that the order must be considered by the Commissioner to be "erroneous in so far as it is prejudicial to the interests of the Revenue". This provision has been interpreted by the Supreme Court in several judgments to which it is now necessary to turn. In **Malabar Industrial Co.Ltd. vs. CIT**,[1] the Supreme Court held that the provision "cannot be invoked to correct each and every type of mistake or error committed by the Assessing Officer" and "it is only when an order is erroneous that the Section will be attracted". The Supreme Court held that an incorrect assumption of fact or an incorrect application of law, will satisfy the requirement of the order being erroneous. An order passed in violation of the principles of natural justice or without

1 (2000) 243 ITR 83 (SC)

application of mind, would be an order falling in that category. The expression "prejudicial to the interests of the Revenue", the Supreme Court held, it is of wide import and is not confined to a loss of tax. What is prejudicial to the interest of the Revenue is explained in the judgment of the Supreme Court:

> "The phrase "prejudicial to the interests of the Revenue" has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of the Revenue. For example, when an Income-tax Officer adopted one of the courses permissible and the Income-tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue, unless the view taken by the Income-tax Officer is unsustainable in law."

The principle which has been laid down in **Malabar Industrial Co.Ltd.** (supra) has been followed and explained in a subsequent judgment of the Supreme Court in **Commissioner of Income Tax vs Max India Ltd**. [2] While interpreting the provisions of Section 80HHC(3), the Supreme Court noted that the statutory provision had been amended eleven times and different views existed on the day when the Commissioner passed his order under Section 263.

2 (2007) 295 ITR 282 (SC)

The Court observed that "the mechanics of the section have become so complicated over the years that two views were inherently possible." Consequently, the subsequent amendment to the statutory provision, even though it was retrospective, would not attract the provisions of Section 263 particularly when the provision of law, as it stood, on the date when the Commissioner passed the order under Section 263, would have to be taken into account.

12. In **Commissioner of Income Tax vs. Gabriel India Ltd.**,[3] a Division Bench of this Court observed that Section 263 does not confer an arbitrary or uncharted power on the Commissioner. In considering as to whether an order is erroneous in so far as it is prejudicial to the interests of the Revenue, the Commissioner must be guided by the material on the record. The power of *suo motu* revision under Section 263(1), is in the nature of supervisory jurisdiction. Two circumstances must exist in order to enable the Commissioner to exercise the power, namely, (i) the order must be erroneous; and (ii) by virtue of the order being erroneous,

3 203 ITR 108

prejudice must have been caused to the interests of the Revenue. Section 263 does not empower the Commissioner to substitute his judgment for that of the Assessing Officer, unless the decision is held to be erroneous. Both the conditions for the exercise of the power must be fulfilled. The order, in other words, sought to be revised, must be erroneous and must be prejudicial to the interests of the Revenue.

13. The question as to whether the Commissioner has acted within the fold of his jurisdiction under Section 263 or outside it, in the present case, must be decided with reference to the principles which have been laid down by the Supreme Court and by this Court. Section 41(1) provides that where an allowance or deduction has been made in the assessment for any year in respect of a loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year, the assessee obtained whether in cash or in any other manner, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtains or the value of the benefit accruing shall be deemed to be

profits and gains of business or profession and would accordingly be chargeable to income as the income of that previous year. The State Legislature enacted the Kerala Forest Produce (Fixation of Selling Price) Act, 1978. Section 3(1) empowers the Government to fix the selling price of forest produce for the following financial year. Section 5 stipulated that after the publication of the notification under Section 3, no forest produce shall be sold by the Government at a price which is less than the notified selling price. On 9th March 1979, the Government of Kerala issued notifications in exercise of its power under the Act of 1978 for the period ending 31st March 1981 and also for the period commencing from 1st April 1981, being the previous year relevant to Assessment Year 1982-83. The assessee had been allowed a deduction of an amount of Rs.1.75 crores during the Assessment Years 1980-81, 1981-82 and 1982-83. The notifications that were issued by the State Government were challenged by the assessee before the Kerala High Court. By its judgment dated 15th April 1981, the High Court struck down the notifications in so far as they related to eucalyptus, on the ground that in fixing the prices for eucalyptus, the State Government had not followed the procedure prescribed by the Act.

The Kerala High Court held that matters which were required to be considered had not been placed before the Committee which was statutorily to be constituted under the provisions of the Act and the Committee had failed to consider relevant material before making its recommendations, in regard to the price of eucalyptus. The judgment of the Kerala High Court, therefore, set aside the notifications on the ground that the mandate of the Act in fixing the price of forest produce had not been followed and that relevant consideration had not been borne in mind by the Committee. The liability of the assessee to pay arose by virtue of the provisions of Section 5 of the Act, under which, no forest produce could be sold by the Government at a price, which was less than the selling price; the selling price being defined to mean that the price of forest produce fixed by the Government under Section 3. The judgment of the Kerala High Court did not prohibit the government from issuing a fresh notification. After the decision of the Kerala High Court, the Expert Committee constituted under the provisions of Section 4, convened for the purposes of deciding afresh, the selling price of eucalyptus upto 31st March 1982. The Committee held its meeting on 25th March 1982, which was six days before the end of

the relevant period here, and recommended the fixation of the selling price of eucalyptus between Rs.328/- to Rs.384/- per metric ton between 1978 and 1981. The Special Secretary to the State Government in the Forest and Minor Irrigation Department recorded in a note dated 27th March 1982 that the Kerala Forest Produce (Fixation of Selling Price) Rules, 1978 had been amended on 28th May 1981. Some doubt was expressed as to whether these Rules could fasten a liability with retrospective effect in the absence of an amendment to the parent legislation. The State Government, in pursuance of the judgment of the Kerala High Court proceeded to issue fresh notifications on 31st March 1981, 29th April 1981 and 29th May 1981. By the notification dated 29th May 1981, the Government refixed the selling price in the year 1981-82 with effect from 1st June 1981. On 31st March 1982, selling prices were notified for the period from 1st April 1982. These notifications were once again challenged by the assessee in a Writ Petition before the Kerala High Court. The Petition was allowed by the Division Bench of the Kerala High Court on 28th May 1994 and the notifications were set aside with a declaration that the prices fixed of bamboo, reed and eucalyptus were not

payable by the Petitioner. The judgment of the Kerala High Court did not conclude the proceedings. Special Leave Petitions were filed before the Supreme Court in which, while granting leave, interim orders were passed by the Supreme Court, directing the assessee to pay the price of forest produce at 60% of the rate fixed in the notification issued by the State Government under Section 3(e) of the Act, less the price already paid. The Bank Guarantees furnished by the assessee were allowed to be encashed to the aforesaid extent. The Supreme Court expressed the hope that the parties would be able to arrive at a settlement which may be "beneficial to all concerned, **having regard to the checkered history of the litigation with its attendant uncertainties, and to avoid further long drawn out litigation.**" Eventually, a settlement was arrived at between the Government of Kerala and the assessee on 27th October 1988. By the settlement, a series of matters set out in the schedule, came to be settled and parties agreed that no payment will be due by either party to the other in respect of any of the matters mentioned in the schedule.

14. The narration of facts would thus show that the liability

of the assessee in respect of the payment due for the supply of forest produce, under the Kerala Forest Produce (Fixation of Selling Price) Act, 1978, was not concluded by the judgment of the Kerala High Court dated 15th April 1981. The notifications fixing the price of eucalyptus were set aside by the Kerala High Court, on the ground that the Committee statutorily constituted under the Act, had not applied its mind to the relevant material. The liability of the assessee to pay at the price notified, arose under the Act, for the supplies of forest produce effected by the State Government to the assessee. The liability arose as a result of the supply of forest produce the quantification of liability was liable to be made by the instrument of the notifications issued in accordance with the provisions of the Act. The view that there was no remission or cessation of the liability during the previous year, relevant to Assessment Year 1982-83, was a possible view having regard to the circumstances, which transpired after the judgment of the Kerala High Court. These circumstances included the following: (i) The recommendations made by the Expert Committee on 25th March 1982 for the refixation of prices of forest produce six days before the end of the financial year; (ii) The issuance of fresh

notifications by the State Government; (iii) The challenge by the assessee to the fresh notifications; (iv) The judgment of the Kerala High Court dated 28th May 1984, setting aside the second set of notifications; (v) The filing of Special Leave Petitions before the Supreme Court challenging the judgment of the Kerala High Court in the second round; and (vi) The interim order passed by the Supreme Court requiring the assessee to pay at the rate of 60% of the prices/notifications and allowing encashment of Bank Guarantees for that purpose; and (vii) The eventual resolution of the dispute by a settlement of 27th October 1988.

15. In these circumstances, when the Assessing Officer took a possible view, while passing an order of assessment, the Commissioner exceeded his jurisdiction in seeking recourse to his power under Section 263. At the least, it must be held that the question as to whether the liability of the assessee had ceased in the previous year relevant to the Assessment Year 1982-83, was an issue on which a possible view was that there was no final or irrevocable remission or cessation of liability, within the meaning of Section 41(1) of the Act, during Assessment Year 1982-83. This

view could not, by any stretch of logic, be regarded as being unsustainable in law. The condition precedent to the exercise of jurisdiction under Section 263, is that the order sought to be revised must be erroneous in so far as it is prejudicial to the interests of the Revenue. Following the judgments of the Supreme Court in **Malabar Industrial Co**. and **Max India Ltd.** (supra), it is now a settled principle that where the Assessing Officer has adopted one of the courses permissible in law or where two views are possible and the Assessing Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Assessing Officer is unsustainable in law. In the present case, two views were inherently possible and the assessee therefore, cannot be subjected to the exercise of the jurisdiction under Section 263. The Tribunal, with respect, has adopted a rather simplistic view of the matter, in coming to the conclusion that the liability had ceased to exist, consequent upon the judgment of the Kerala High Court, dated 15th April 1981. This clearly overlooks the checkered history of the litigation. The fact that the litigation had a checkered history was noted in the interim

order of the Supreme Court, which also referred to the "attendant uncertainties" and to the possibility of a "further long drawn out litigation".

16. For all these reasons, we are of the view that the order of the Tribunal was unsustainable. The reference would, consequently, be answered with the finding that the Tribunal was not justified in upholding the order of the Commissioner of Income Tax, passed under Section 263, directing the Assessing Officer to include the sum of Rs.1,75,32,600/- in the total income of the assessee under Section 41(1), in the previous year, relevant to Assessment Year 1982-83, on the ground that there had been complete cessation of the liability during that period. The reference is answered accordingly. In the circumstances of the case, there shall be no order as to costs.

(Dr.D.Y.Chandrachud, J.)

(J.P.Devadhar, J.)