

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

INCOME TAX APPEAL NO.1311 OF 2009

M/s.Ranka Jewellers,
having their office at 114,
Ravivar Peth, Pune-411 002.

...Appellant.

Vs.

1. Additional Commissioner of Income Tax,
Central Range-1, Pune & Anr.

...Respondents.

....

Mr. Soli E.Dastur, Sr.Advocate with Mr.Nishant Thakkar i/b.
Mr.Atul K. Jasani for the Appellant.
Mr.Vimal Gupta for the Respondent.

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

March 26, 2010.

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

The appeal by the Assessee under Section 260A of the
Income Tax Act, 1961, has been admitted on the following
substantial question of law:

“Whether the ITAT was right in holding that the Second
Respondent had validly invoked jurisdiction and
exercised powers under Section 263 of the Income Tax
Act, 1961.”

2. The Assessee manufactures and trades in gold jewellery and silver articles. A search was conducted at its premises on 24th October 2002. A Special Audit was carried out under Section 142(2A). By an order dated 31st December 2004, a block assessment was completed for the period 1st April 1996 to 24th October 2002 under Section 158BC. The undisclosed income of the assessee was estimated at Rs.5.23 crores. A notice was issued on 9th February 2007 by the Commissioner of Income Tax (Central) to the assessee to show cause why the order of assessment should not be revised in exercise of powers under Section 263. The assessee responded to the notice following which an order was passed on 26th March 2007 by the Commissioner of Income Tax (Central) under Section 263, setting aside the order of block assessment and directing the Assessing Officer to pass a fresh order of assessment.

3. The power under Section 263 has been exercised on two grounds which are elucidated in the notice dated 9th February 2007 that was issued to the assessee. The *first* ground is that during the course of the search and seizure action, documents which were

seized revealed the purchase and sale of gold and silver jewellery which was not disclosed to the Department. These documents included “Jama Kharch Panas” for the period 2nd November 1999 to 17th September 2002. The CIT (Appeals), on a reference made by the Assessing Officer estimated the initial investment of the assessee at Rs.10 lakhs on the basis of an average turnover of Rs.75 lakhs. According to the revising authority, the average turnover was computed only for the first three years of the block period, while for the subsequent part of the block period, the undisclosed turnover, which was much higher, was not considered by the CIT(A). According to the revisional authority, the initial investment determined of Rs.10 lakhs is not commensurate with the investment required to achieve a substantially higher turnover of Rs.38 crores, in the subsequent period of the block, starting from Financial Year 1999-2000 till the date of search. Accordingly, it has been stated that because of the failure to determine the initial investment, particularly with reference to the undisclosed turnover during Financial Year 1999-2000 and onwards, the assessment order issued by the Assessing Officer is erroneous and prejudicial to the interests of the Revenue.

4. The *second* ground on which the power under Section 263 has been exercised, is that the seized material revealed for the period between 1999-00 and 2002-03 total purchases of Rs.93.76 crores by the assessee in cash. Under Section 40A(3), twenty percent of these purchases should have been disallowed. The Assessing Officer having failed to do so, it has been concluded that the assessment order is erroneous and prejudicial to the interest of the Revenue.

5. These are the two grounds on which the jurisdiction under Section 263 has been exercised. The submission of the Assessee is that neither of these grounds can sustain a valid exercise of power under Section 263. The Revenue contends that the invocation of the jurisdiction under Section 263 is proper. For convenience of exposition, it would be appropriate to consider the challenge to the exercise under Section 263 on the aforesaid two grounds separately, taking the second ground up for consideration initially.

Re: Section 40A(3):

6. During the course of the block assessment proceedings, on 2nd June 2004, the Assessing Officer called for a Special Audit under Section 142(2A). The audit was required inter alia in respect of cash transactions which fell within the ambit of the provisions of Section 40A(3). The audit report contained the following observations on the issue of the cash transactions, particularly with reference to Section 40A(3):

“The details of cash payments in excess of limits specified u/s.40A(3) are given in Para 11 of Audit Report wherein pagewise explanation of seized material is given. However, since a consolidated figure of purchase and expense is given in Jama-kharch papers it is not possible to state whether any individual payment is made in excess of limits specified u/s.40A(3). The Assessee has explained that in view of decision in case Janata Tiles 66 TTJ 695, Sharma Associates 55 ITD 171 & Madhuban House Building Co-op. Society 76 TTJ 948 the undisclosed transactions are outside purview of section 40A(3). The A.O. may consider this decisions.”

Thereafter, an internal audit query was raised within the Department on the ground that purchases amounting to Rs.93.76 crores were made in cash and that twenty percent thereof, which

works out to Rs.18.75 crores, should be disallowed under Section 40A(3) and added to the taxable income. Shri S.K.Rastogi, Additional Commissioner of Income Tax, Central Range-1, Pune, who was the Assessing Officer observed that the audit observation was not correct. In his response, the Assessing Officer noted that as per the seized documents, the figures of purchases made were consolidated lumpsum figures and it was difficult to infer as to whether there was any violation of Section 40A(3). The Assessing Officer noted that in a series of decisions, the Income Tax Appellate Tribunal had held that where the undisclosed income had been found out by estimating gross profit, or where the assessee was carrying on business outside the books of account, the provisions of Section 40A(3) would be inapplicable. In forming this view, the Assessing Officer relied upon the decision of the Ahmedabad Bench of the ITAT in **Hynoup Food & Oil Industries (P) Ltd.**;¹ of the Pune Bench in **Sharma Associates**;² and of the Mumbai Bench in **Western India Bakers (P) Ltd.** Some of these decisions, had also been relied upon in the report of the Auditor in the Special Audit Report under Section 142(2A). Both the reports

1 48 ITD 202

2 55 ITD 171

of the Special Auditor as well as of the Assessing Officer who responded to the audit query, relied upon decisions of the Tribunal in support of their view that there was no violation of the provisions of Section 40A(3). The view of the Assessing Officer was confirmed by the CIT (Central) in the following terms:

“It is evident from the report of Addl.CIT, CR-1, Pune who was also the Assessing Officer in the case, that the observations made by the Revenue Audit are not acceptable. Therefore, in my considered opinion, there is no mistake committed by the Assessing Officer.”

The response which was generated from the Assessing Officer and from the Commissioner of Income Tax (Central) appears from the records to have been remitted under a covering letter dated 19th June 2006 of the Additional Commissioner of Income Tax, Central Range-1, Pune.

7. The grievance of the assessee is that despite the fact that the issue of the applicability of Section 40A(3) formed the subject matter of the Special Audit and though the Assessing Officer did not come to the conclusion that there was any violation of those provisions; on 9th February 2007, a notice was issued under Section

263 by the same Commissioner of Income Tax contrary to his own view which was recorded in response to the audit query.

8. From the material on the record, it has emerged that during the course of the assessment proceedings, the Assessing Officer had directed a Special Audit under Section 142(2A) and among the aspects on which the audit was requisitioned, was the issue relating to transactions which were carried out in excess of an amount of Rs.20,000/- in cash. The auditor came to the conclusion that it was not possible to state as to whether any individual payment had been made in excess of the limit specified in Section 40A(3). The auditor recorded the submissions of the assessee, based on decisions of the Tribunal, that undisclosed transactions were outside the purview of Section 40A(3). Evidently, the Assessing Officer, during the course of the assessment proceedings did not consider that there was any violation of the provisions of Section 40A(3). As a matter of fact, the Assessing Officer in response to the internal audit query relied upon several judgments of the Tribunal in support of his conclusion that the provisions of Section 40A(3) were not applicable and that in any event, it was

his view that it was difficult to infer from the consolidated figures that were available as to whether any individual transaction had taken place in cash in excess of the limit prescribed by the statutory provisions.

9. The order that has been passed by the Commissioner of Income Tax under Section 263 proceeds on the basis that the Assessing Officer did not consider the applicability of Section 40A(3) while determining the undisclosed income and hence, the order appears to be erroneous and to be prejudicial to the interests of the Revenue. There is merit in the submission of the assessee that this finding is contrary to the record. The record shows that the Assessing Officer had applied his mind to the issue of the violation of Section 40A(3) during the course of the assessment proceedings by calling for a Special Audit on several items including the question as regards cash transactions which fell within the purview of Section 40A(3). Similarly, the Tribunal also proceeded on the basis that the record before it did not contain any discussion on the issue. This aspect of the finding of the Tribunal suffers from the same error as the order passed by the Assessing

Officer. Though the assessment order did not contain a specific reference to the applicability of Section 40A(3), the response of the Assessing Officer to the audit query shows that it was his view that those provisions were not applicable to the facts of the present case. The Assessing Officer supported his view with reference to decisions of the Tribunal. This view of the Assessing Officer was also affirmed by the Commissioner of Income Tax. In the circumstances, the exercise of the power under Section 263 cannot be sustained. The revisional jurisdiction could not have been exercised where a possible view was taken on the applicability of Section 40A(3) based on decisions of the Tribunal. It is a settled principle of law that if the view which was taken by the Assessing Officer is a possible view, it would not be within the jurisdiction of the revisional authority to exercise the power under Section 263.

Re: Initial investment or seed capital :

10. The second basis on which the jurisdiction under Section 263 has been exercised is that while determining the initial investment at Rs.10 lakhs, the turnover of Rs.75 lakhs was taken only on the basis of the first three years of the block period. The

Commissioner of Income Tax is of the view that in considering the turnover of only the first three years of the block in determining the initial investment, the substantially higher turnover for the remaining years of the block had been ignored.

11. Now, on this aspect of the case, the record indicates that following the order of assessment, during the pendency of the proceedings before the CIT(A), a request for enhancement was made by the Additional Commissioner of Income Tax, Central Range-1, Pune, by a letter dated 16th May 2005. In his request for enhancement of the returned income, the Additional Commissioner of Income Tax stated that in the block assessment order, an estimation of the initial investment required to carry out undisclosed business had remained to be done for the first year of the block period. The CIT(A) was, therefore, requested to enhance the undisclosed income on account of the initial investment. Following the request for enhancement, by an order sheet entry dated 20th May 2005, the assessee was called upon to explain as to why an enhancement should not be made for the initial investment for undisclosed business transactions. The

assessee's response to the notice governed the entire period of the block assessment. The CIT(A) in the course of the order dated 22nd May 2006 observed as follows in paragraph 16.5:

“There is no denying fact that for the period 02.11.1999 to 17.09.2002 there is seizure of duplicate cash book which is written very scientifically giving full details of incoming and outgoing cash. The undisclosed profit of the appellant and accepted by the department at Rs. 69,33,940/- for the period 1996-97 up to 01.11.1999 can be considered as ploughed back in the unaccounted trading. This profit can be considered as capital used in the undisclosed trading as per the stand taken by the appellant. However, the stand taken by the Assessing Officer that in the first year of the block period initial seed capital requires to be considered also merits consideration. Incidentally, in the first year of the block period i.e. 1996-97 the turnover is not fully based on the seized materials and that the sales and purchases are not fully recorded and that department was constrained to estimate the turnover at Rs.50 lacs. The profit derived therefrom came to Rs.5,35,000/-. The appellant has accepted this finding. Similarly, in the next two years of the block period i.e. for 1997-98 and 1998-99 in the absence of full details, the turnover has once again been estimated at Rs.75 lacs and Rs.1 crore respectively and profit worked out therefrom as per the Assessing Officer and accepted by the appellant came to Rs.8,22,000/- and Rs.14,24,000/- respectively. Since for the first three years of the block period, the turnover and profit are estimated figure, in my considered opinion, it is deemed fit to take average of the turnover of the first three years and then to work out the seed capital by applying a reasonable percentage. The average of the turnover for the three years will work out to Rs.75 lacs and at the rate of 12.5% which is a reasonable percentage, the profit comes to Rs.9,37,500/-. However, this figure is rounded

off to Rs.10,00,000/-. The undisclosed income will go up by Rs.10 lacs as worked out.”

12. The submission of Counsel appearing on behalf of the Assessee is that these observations of the CIT(A) *ex-facie* demonstrate that the Appellate Authority has not merely confined itself to the determination of the initial investment on the basis of the turnover for the first three years of the block, but, as a matter of fact, the Commissioner also estimated what has been ploughed back in unaccounted trading for the remaining years of the block.

13. Reading paragraph 16.5 of the order of the CIT(A), as it stands, there is merit in the submission of the assessee. The order of the CIT(A) refers firstly to the fact that for the period between 1996-97 and 1st November 1999, the undisclosed profit of the assessee was determined at Rs.69.33 lakhs which could be considered as being ploughed back in unaccounted trading. The CIT(A) observed that this profit could be considered as capital used in undisclosed trading. The CIT(A) then noted that the initial seed capital required for the first year of the block period needed to be

estimated. In this regard, the CIT (A) noted that the average turnover for the first three years of the block was Rs.75 lakhs and taking a rate of 12.5% as a reasonable percentage, the profit was worked out at Rs.10 lakhs. This was treated in the order of the CIT(A) as an initial investment for carrying on undisclosed transactions. Both aspects were evidently considered. This is clear from paragraph 16.5 of the order.

14. We must, at this stage, observe that in these proceedings we are not concerned with the merits or correctness of the determination that has been made by the CIT(A) in the order dated 22nd May 2006. The scope of the present proceedings is confined to the validity of the recourse to the powers under Section 263. During the course of the hearing, the Court has also been informed that an appeal is pending before the ITAT in which the correctness of the order dated 22nd May 2006 passed by the CIT(A) will fall for determination. A copy of the authorization memo dated 20th February 2007 issued by the Commissioner of Income Tax (Central) in regard to the filing of the appeal is produced during the hearing. The authorisation memo specifically deals with the

correctness of the order passed by the CIT(A) while enhancing the assessee's income on the request made by the Assessing Officer. The authorization memo states that the Assessing Officer erred in adopting what is described as "an arbitrary percentage of 12.5% of average turnover of Rs.75 lakhs thereby considering estimated turnover of only first three years as seed capital and in not considering huge unaccounted turnover of Rs.38 crores per year in the latter three years of the block". The case of the Revenue in the appeal before the Tribunal is to the effect that the amount estimated at Rs.10 lakhs as initial investment is a gross underestimate to meet the turnover of Rs.38 crores and is lacking in reasonableness. The Court is informed that the ground which is sought to be urged by the Revenue is still to be admitted by the Tribunal. We have adverted to these facts because the correctness of the order that has been passed by the CIT(A) on merits is an issue which, it is open to the Revenue to urge before the Tribunal and for the Tribunal to address. The legitimacy, correctness and maintainability of the ground which is sought to be advanced will be dealt with by the Tribunal. The Revenue having taken recourse to its appellate remedy before the Tribunal, we are of the view that

the exercise of the jurisdiction, in the facts of this case under Section 263 was not warranted since the exercise cannot be sustained under Section.

15. We must also advert to the circumstance that in so far as the second ground for the exercise of the jurisdiction under Section 263 is concerned, there was an audit query specifically with reference to the initial investment made in purchases in the year 1999-2000. The audit query was responded to by the Additional Commissioner of Income Tax. The ACIT in his response to the audit query was of the view that the observation in the audit was not correct. The view of the Additional Commissioner of Income Tax was confirmed by the CIT(Central), Pune. The Commissioner of Income Tax while passing his order under Section 263 has observed that the request for enhancement made by the Assessing Officer to the CIT(A) was only for the first year, namely, A.Y. 1997-98. The Commissioner has proceeded on the basis that the initial investment computed at Rs.10 lakhs was determined only for the first year of the block period and that the CIT(A) did not further examine the issue as to whether the initial investment of

Rs.10 lakhs together with income computed for the first three years would be sufficient to achieve unaccounted sales to the extent to which they emerge during the remaining years of the block assessment. Similarly, the Tribunal has also observed that there was no assessment either by the Assessing Officer or by the CIT(A) in respect of the initial capital for the latter part of the block period. *Ex-facie*, a reading of paragraph 16.5 of the order passed by the CIT(A) would show that this ground which weighed with the Commissioner of Income Tax and with the Tribunal is not correct. Paragraph 16.5 of the order passed by the CIT (A) would show that an estimation was made of the initial investment based on the turnover of the first three years of the block period. Having done so, the CIT(A) also computed undisclosed profits for the period 1996-97 till 1st November 1999 which he treated as being ploughed back in unaccounted trading. This would indicate that the CIT (A) had dealt not merely with the initial investment required on the basis of the turnover for the first three years of the block, but also made an estimation of the profits which were ploughed back in the unaccounted sales during the subsequent period between 1996 and 1st November 1999. Be that as it may, it

would be necessary for this Court to clarify that the merits of the aforesaid determination will fall for consideration before the Tribunal in the pending appeal. We have not expressed any opinion one way or other on the merits of the determination which has been made by the CIT(A).

16. The position in law was settled by the judgment of the Supreme Court in **Malabar Industrial Co.Ltd. vs. CIT.**³ In **CIT vs. Max India Ltd.**,⁴ the Supreme Court while adverting to the earlier judgment in **Malabar** has laid down the following principle of law:

“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 in law and it has resulted in loss of revenue; or where two views are possible 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.”

17. The power under Section 263(1) can be exercised by the Commissioner where he considers that any order passed by the

3 (2000) 243 ITR 83

4 (2007) 295 ITR 282

Assessing Officer is erroneous in so far as it is prejudicial to the interests of the Revenue. Explanation (c) to the provision provides that where any order referred to in Sub-section (1) and passed by the Assessing Officer has been made a subject matter of any appeal, the powers of the Commissioner under the sub-section shall extend to such matters as had not been "considered and decided" in the appeal. In other words, the exercise of power under Section 263(1) is in respect of an order passed by the Assessing Officer, where the order is regarded as being erroneous and prejudicial to the interest of the Revenue. Where an order passed by the Assessing Officer is subject to an appeal that has been filed, the power of the Commissioner to invoke his revisional jurisdiction under Section 263 can only extend to such matters which have not been considered and decided in the appeal. The words which have been used in Explanation (c) to Sub-section (1) of Section 263 are "considered and decided". In other words, it is not merely a consideration that disables, but the matter has to be considered and decided in the appeal. The submission of Counsel appearing on behalf of the Revenue that the CIT(A) has not decided the issue, while dealing with the question of enhancement, cannot be

accepted. The submission which has been urged on behalf of the Revenue is that the CIT(A) was requested to exercise his power of enhancement in pursuance of the request made by the Additional Commissioner of Income Tax on 20th May 2005 and that the request which was made was to carry out an estimation of the initial investment for the first year of the block period. Now, the power of the CIT(A) is structured by the provisions of Section 251. Section 251 inter alia provides that in disposing of an appeal the Commissioner of Income Tax (Appeals) shall have the power in an appeal against an order of assessment to confirm, reduce, enhance or annul the assessment. Consequently, when a request for enhancement was made to the Commissioner of Income Tax (Appeals), he had the jurisdiction, in terms of Section 251, to confirm, reduce, enhance or annul the assessment. A reading of the order passed by the CIT(A), particularly paragraph 16.5 of the order, would lead to the conclusion that the Commissioner of Income Tax (Appeals) had considered and decided the issue. Once the issue was considered and decided by the Commissioner of Income Tax (Appeals), the remedy of the Revenue cannot lie in the invocation of the jurisdiction under Section 263. The Revenue

has already invoked its remedy in the form of a substantive appeal before the Tribunal which will be decided in accordance with law. The observations in this order are confined to determining whether the invocation of jurisdiction under Section 263 was valid. These observations will not affect the determination of the issues which are raised in the appeal to the Tribunal.

18. For the reasons aforesaid, we dispose of the appeal by answering the question as framed in the negative, in favour of the assessee and against the Revenue. There shall be no order as to costs.

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

(J.P.Devadhar, J.)