

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

WRIT PETITION NO.79 OF 2013
AND
WRIT PETITION NO.80 OF 2013
AND
WRIT PETITION NO.81 OF 2013
AND
WRIT PETITION NO.82 OF 2013

M/s.OHM Stock Brokers Pvt.Ltd.

Petitioner

versus

Commissioner of Income Tax-4, Mumbai
and another

Respondents

Mr.S.C.Tiwari with Ms.Natasha Mangat for Petitioner.

Mr.A.R.Malhotra for Respondents.

**CORAM : DR.D.Y.CHANDRACHUD AND
A.A.SAYED, JJ.**

DATE : 20 February 2013

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

1. Rule. Counsel for the Respondents waive service. By consent, the Rule is made returnable forthwith. The writ petitions are taken-up for hearing and final disposal, by consent and on the request of learned counsel.

2. This judgment will govern four petitions under Article 226 of the Constitution where the assessee has challenged notices for reopening of assessments for Assessment Years 2005-06, 2006-07, 2007-08 and 2008-09. The notices under section 148 of the Income Tax Act, 1961 ('the Act') in relation to A.Ys.2005-06 and 2006-07 have admittedly been issued beyond a period of four years of the end of the relevant assessment year. These notices would, therefore, be governed by the rigour of the requirement which has been spelt out in the proviso to Section 147 of the Act. Since the assessments for those years were completed under section 143(3), the reopening of the assessments could be valid only if there was a failure on the part of the assessee "to disclose fully and truly all material facts necessary for his assessment for that assessment year". For A.Ys.2007-08 and 2008-09, the reopening is admittedly within a period of four years of the end of the relevant assessment year. The test to be applied, in view of the decision of the Supreme Court in **Commissioner of Income Tax Vs. Kelvinator of India Limited**¹, is whether, as the assessee submits, the reopening was based purely on a change of opinion or whether, there was tangible material on the basis of which the assessing officer could have proceeded to reopen the assessments. For convenience of exposition and since the reasons for reopening the assessments are similar, we are dealing with the batch of petitions by a common judgment. However, having regard to the fact that a different test would govern the two petitions where the reopening is beyond four years, we will deal with those separately.

1 (2010)320-ITR-561 (SC)

ASSESSMENT YEARS 2005-06 AND 2006-07

3. For assessment year 2005-06, the assessee filed a return of income on 30 October 2005, declaring a total income of Rs.9.82 crores. The assessee carries on business as a share and stock broker and carries out trading and investment in shares and securities. During the period relevant to A.Y.2005-06, the assessee paid remuneration of Rs.9.83 crores to each of its two directors which included remuneration by way of commission/performance bonus of Rs.9.50 crores to each of the said directors. These amounts were reflected in Schedule-10 of the Balance Sheet as on 31 March 2005 and the Profit and Loss Account for the year ending on that date. These amounts were also reflected in Annexure-IV forming part of the Tax Audit Report in Form-3CD. During the course of the assessment proceedings, the A.O. called upon the Petitioner to justify the remuneration in terms of Section 40A(2)(b). By a letter dated 12 March 2007, the assessee responded to the request of the A.O. for a disclosure of the nature of business and the shareholding pattern. The agreements between the assessee and its two directors respectively dated 15 April 2003 were disclosed before the A.O. By a letter dated 31 August 2007, the assessee informed the A.O. that remuneration of Rs.9.83 crores was paid to each of the two directors, which was inclusive of Rs.9.05 crores paid as commission in pursuance of the agreement dated 15 April 2003. The assessee stated that for the year under consideration, the income from share business stood at Rs.31.82 crores and having regard to the volatility of the market, the payment of a fixed remuneration to the two directors would have resulted in difficulties in the event of income being lower than for the previous

year. As a matter of fact, it was stated that the income from the share business of Rs.31.82 crores for the year in question was lower than the income of Rs.45.25 crores for the immediately preceding year. The payment to the directors was therefore, it was stated, decided on the basis of a fixed monthly remuneration of Rs.10.00 lakhs in addition to which a commission calculated at a pre-determined rate of 35% of the net profit before provision for income tax, was paid. Following these disclosures by the assessee, an order of assessment was passed under section 143(3) on 24 December 2007 for A.Y.2005-06. From the record it appears that for A.Y. 2008-09, an audit objection was raised by the Senior Audit Officer. The audit objection was subsequently withdrawn in pursuance of an order of the Director General dated 7 April 2011.

4. A notice was issued to the Petitioner on 30 March 2012, seeking to reopen the assessment for A.Y.2005-06. In pursuance of a request made by the Petitioner for disclosure of reasons, the following reasons were furnished for reopening the assessment under section 148 :

"The assessee filed return income of Rs.9,82,39,900/- on 31.10.2005. The return was processed u/s 143(1) of the Income Tax Act, 1961. Order u/s 143(3) was passed on 24.12.2007 determining the total income of Rs.9,89,17,043/-.

On perusal of P & L a/c. it is observed that the assessee has paid commission of Rs.19,00,00,000/- to Directors. In the A.Y. 2009-10, the assessing officer found that this payment is made to Directors who are shareholders in the company. As per section 36(1)(ii), only such commission payments are allowed as expenditure as "any sum paid to an employee as bonus or commission for services rendered, where such sum

would not have been payable to him as profits or dividend, if it had not been paid as bonus or commission." Clearly, the payments being made to the shareholders are not covered under this section to be eligible for deduction as the same could have been made to the director who is a shareholder as disbursement of profit or dividend. Since, the assessee has violated the provisions of section of 36(1)(ii) in making such claim of commission payment as expenditure, I have reasons to believe that income chargeable to tax has escaped the assessment."

The Petitioner objected to the reopening of the assessment by a letter dated 22 October 2010 stating, inter alia, that there was no failure on the part of the Petitioner to disclose fully and truly all material facts necessary for the assessment and hence the requirement for reopening of the assessment for the year in question was not fulfilled. The Petitioner urged that during the course of the assessment there was a full disclosure of the material facts and the A.O. was informed that a commission/performance bonus was paid to the directors and it was after the A.O. was satisfied about the genuineness and the reasonableness of the payments and of the allowability of the deduction that the assessment was completed, without making any addition, under section 143(3). These objections have been disposed of by an order dated 3 December 2012.

5. The reopening of the assessment for A.Y.2006-07 is on similar grounds, as jointly stated before the Court on behalf of the assessee and the Revenue.

6. On behalf of the Petitioner it has been urged that :

(i) Both for A.Y.2005-06 and 2006-07 the notices under Section 148 have been issued beyond a period of four years of the end of the assessment year;

(ii) The original assessments were completed under Section 143(3) and hence the reopening would be contrary to law unless there was a failure on the part of the assessee to fully and truly disclose all the material facts necessary for the assessment for those assessment years;

(iii) Ex-facie, the reasons which have been disclosed to the assessee do not even purport to state that there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment;

(iv) On the contrary, the record would indicate that there was a full disclosure of the factum of payments, of the agreements under which commission/performance bonus was paid and of the basis for the payments and there was a detailed explanation on the part of the assessee justifying the payments; and

(v) In respect of the years in question, the assessee proceeded to deduct tax at source on the basis that what has been paid to the directors is salary income. The directors filed their returns of income and assessments in their hands have been completed under section 143(3) accepting the returns of income. After the amounts have been taxed as salary, the assessments of the Petitioner are now sought to be

reopened by taxing the amounts as profits in the hands of the company after the expiry of a period of four years.

Counsel for the Revenue has supported the reopening of assessments on the grounds as set out in the reasons disclosed.

7. Under the proviso to Section 147, where an assessment has been completed under Section 143(3), the validity of a reopening beyond four years of the end of the relevant year is pre conditioned by the requirement that there is a failure on the part of the assessee to fully and truly disclose material facts necessary for the assessment for that assessment year. Section 147 in its present form was brought into the statute by an Amending Act of 1997 with effect from 1 April 1989. There must be a failure on the part of the assessee to fully and truly disclose material facts for the assessment for the jurisdiction of A.O. to be invoked.

8. In the present case, the notices purporting to reopen the assessments for both A.Y.2005-06 and 2006-07 do not even allege that there was any such failure on the part of the assessee. On the contrary, the record would indicate that the assessee had initially by a letter dated 12 March 2007 and subsequently by a letter dated 31 August 2007 placed on the record before the A.O. the nature of payments, the agreements with the two directors in pursuance of which they were paid a fixed monthly remuneration and a commission/performance bonus representing 35% of the net profit before taxation and a justification for the payment. The A.O. was apprised by the Assessee of all the material facts necessary for the assessment and there was no suppression. No such submission has in addition, been urged by the Revenue.

9. The A.O. has sought to reopen the assessments on the ground that under Section 36(1)(ii) only such commission payments are allowed as expenditure as "any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend, if it had not been paid as bonus or commission". The A.O. has stated that a payment made to a shareholder would not be covered by the section to be eligible for deduction as the payment could have been made to a director who is a shareholder as disbursement of profit or dividend. These reasons are not postulated on there being any suppression on the part of the assessee or a failure on the part of the assessee to state fully and truly all material facts necessary for the assessment. It is an admitted position that for A.Y.2006-07 as well, the position is same. Hence, for these reasons, we have come to the conclusion that the reopening of the assessments for 2005-06 and 2006-07 does not fulfill the requirement set out in the proviso to Section 147 and that the notices of reopening would accordingly have to be quashed and set aside. We order accordingly.

ASSESSMENT YEARS 2007-08 AND 2008-09

10. For 2007-08, the assessee filed a return of income on 26 October 2007 declaring a total income of Rs.14.23 crores. During the course of the previous year relevant to the assessment year, the assessee paid a remuneration of Rs.18.25 crores to each of its directors which was inclusive of remuneration by way of a commission/performance bonus of Rs.17.65 crores each. The A.O. issued a questionnaire to the

assessee on 16 February 2009 calling, inter alia, for the details of the shareholding pattern and for establishing the genuineness and reasonableness of the payments made to the persons specified under Section 40A(2)(b). For the assessment year under question, the assessee had shown the amounts in Schedule-10, forming part of the Balance Sheet and the Profit and Loss Account, as well as in Annexure-IV which forms part of the Tax Audit Report. In response to the questionnaire, the assessee submitted a communication on 4 September 2009 along the same lines as was addressed during the course of A.Y.2005-06 (noted above) explaining the nature and extent of the payment and seeking to justify the payment of a fixed monthly remuneration together with a commission at the rate of thirty five percent of the net profits. An order of assessment was passed under section 143(3). The reopening of the assessment is sought to be justified on the basis of the same reasons as indicated for A.Ys. 2005-06 and 2006-07.

11. The contention of the assessee here is that though the reopening of the assessments for A.Y.2007-08 and 2008-09 is within a period of four years, the A.O. has purported to do so on the basis of a mere change in opinion which is impermissible having regard to the judgment of the Supreme Court in **Commissioner of Income Tax Vs. Kelvinator of India Limited (supra)**. Moreover, it has been urged that tax was deducted at source by the assessee while making the payments to two directors; the directors in turn filed their own returns and assessments have been completed under section 143(3) taxing the amount in their hands as salary income. It is thus urged that the reopening was on the basis of mere change in opinion which is impermissible.

12. On the other hand, it has been urged on behalf of the Revenue that a verification by the A.O. of the reasonableness of the payments under section 40A(2)(b) is distinct from the question as to whether the amount paid to the directors falls within the purview of Section 36(1)(ii). According to the Revenue, during the course of the assessment proceedings, there was no formation of opinion by the A.O. at all since the order of assessment does not deal with the question as to whether the payments fall within the purview of Section 36(1)(ii). Hence, it was urged that there would not be only a change of opinion.

13. Though the power of the A.O. to reopen an assessment within a period of four years is indisputably wider than when an assessment is sought to be reopened beyond four years, the power is nonetheless not unbridled. After the amendment which was brought in by the Direct Tax Laws Amendment Act, 1987 with effect from 1 April 1989, the A.O. must have reason to believe that income has escaped the assessment. At the same time, the A.O. is not conferred with the power to review an assessment and he cannot reopen an assessment only because of a mere change in the opinion. The A.O. must, in other words, have tangible material to come to the conclusion that there is an escapement of income. The mere fact that the order of assessment did not specifically deal with the issue as to whether the payment fell within the purview of Section 36(1)(ii) is not dispositive in the present case. The test is as to whether the assessee had furnished to the A.O. all the primary facts on the basis of which a deduction was claimed in respect of the commission that was paid to the two directors for services rendered. The record before the Court indicates that the

assessee had specifically placed before the A.O. by its letter dated 4 September 2009, copies of the agreements dated 16 June 2005 between the assessee and its directors in pursuance of which remuneration was paid to them for the relevant year which included the payment of commission. The attention of the A.O. was clearly and specifically drawn to the quantum of the fixed monthly remuneration and in addition to the payment of commission which is computed at a stipulated proportion of the net profits. The assessee explained the basis on which a decision was taken to make the payment of commission at a fixed monthly remuneration and the rest at a proportion of the net profits. According to the assessee, this decision was based on the volatility of the stock market and having regard to the fact that the income of the assessee from share business had reduced and in fact, it was Rs.35.51 crores in comparison to the income of Rs.57.07 crores for the previous year. This is, therefore, a case where the nature of the payment, the basis of the computation and the rationale for computing the remuneration to the two directors with reference to a fixed remuneration in part and a proportion of the net profits in balance was brought in focus before the A.O. Hence, all the primary facts for the purpose of a deduction under Section 36(1)(ii) were placed before the A.O. That the order of assessment under Section 143(3) accepted the claim on this issue is what matters. Before this Court it is not in dispute at the hearing that the two directors have been assessed under section 143(3) on the amounts paid by the assessee to them as salary income. The Revenue has admittedly treated the amounts paid to the directors in question as salary income in their hands and their assessments have been completed accordingly. In this view of the matter, the reopening of the assessments for the

A.Y.2007-08 must be held to be based on a pure change of opinion and not on tangible material.

14. The following principle which has been enunciated in the judgment of the Supreme Court in **Commissioner of Income Tax Vs. Kelvinator of India Ltd.**¹ must govern :

"4. On going through the changes, quoted above, made to Section 147 of the Act, we find that, prior to Direct Tax Laws (Amendment) Act, 1987, reopening could be done under above two conditions and fulfillment of the said conditions alone conferred jurisdiction on the AO to make a back assessment, but in S.147 of the Act (w.e.f. 1st April, 1989), they are given a go by and only one condition has remained, viz., that where the AO has reason to believe that income has escaped assessment, confers jurisdiction to reopen the assessment. Therefore, post 1st April, 1989, power to reopen is much wider. However, one needs to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, S.147 would give arbitrary powers to the AO to reopen assessments on the basis of "mere change of opinion", which cannot be per se reason to reopen. We must also keep in mind the conceptual difference between power to review and power to reassess. The AO has no power to review; he has the power to reassess. But reassessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of reopening the assessment, review would take place. One must treat the concept of "change of opinion" as an inbuilt test to check abuse of power by the AO. Hence, after 1st April, 1989, AO has power to reopen, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. Our

¹ (2010)320-ITR-561

view gets support from the changes made to S.147 of the Act, as quoted hereinabove. Under the Direct Tax Laws (Amendment) Act, 1987, Parliament not only deleted the words "reason to believe" but also inserted the word "opinion" in S.147 of the Act. However, on receipt of representations from the companies against omission of the words "reason to believe", Parliament re-introduced the said expression and deleted the word "opinion" on the ground that it would vest arbitrary powers in the AO. We quote hereinbelow the relevant portion of Circular No.549, dt.31st Oct. 1989 [(1990)82-CTR (ST)-1], which reads as follows :

"7.2 Amendment made by the Amending Act, 1989, to re-introduce the expression 'reason to believe' in S.148.- A number of representations were received against the omission of the words "reason to believe" from S.147 and their substitution by the 'opinion' of the AO. It was pointed out that the meaning of the expression, 'reason to believe' had been explained in a number of Court rulings in the past and was well settled and its omission from S.147 would give arbitrary powers to the AO to reopen past assessments on mere change of opinion. To allay these fears, the Amending Act, 1989, has again amended S.147 to reintroduce the expression 'has reason to believe' in place of the words 'for reasons to be recorded by him in writing, is of the opinion'. Other provisions of the new S.147, however, remain the same."

15. Following the principle which has been enunciated in the Supreme Court decision, we have come to the conclusion that the reopening of the assessment for A.Y.2007-08 was on a mere change of opinion and was impermissible in law. No separate submissions have

been urged by either side for A.Y.2008-09, the Court being informed by counsel for the assessee and for the Revenue that the reopening is on similar grounds.

16. For these reasons, we have come to the conclusion that the reopening of the assessments under section 148 for A.Ys.2005-06, 2006-07, 2007-08 and 2008-09 is contrary to law. We allow the petitions by quashing and setting aside the notices issued under Section 148 of the Income Tax Act, 1961 for the aforesaid years. Rule is accordingly made absolute. There shall be no order as to costs.

(DR.D.Y.CHANDRACHUD, J.)

(A.A.SAYED, J.)

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