IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

WRIT PETITION NO. 2665 OF 2007

Nirmal Bang Securities Pvt.Ltd. ... Petitioner
v/s
The Assistant Commissioner of Income Tax, Central Circle 41, Mumbai and others ... Respondents

Mr R. Murlidharan i/b Mr Atul K. Jasani for Petitioner.
Mr A.R. Malhotra for Respondents.

CORAM : M.S. SANKLECHA AND
B.P. COLABAWALLA JJ.

Reserved on : 8th January, 2016
Pronounced on : 18th January, 2016

Judgment [Per B.P.Colabawalla J.] :-

1. By this Petition under Article 226 of the Constitution of India, the Petitioner challenges the notice dated 30th March, 2007 (for short, the **"impugned notice"**) issued by Respondent No.1 under section 148 of the Income Tax Act, 1961 (for short, **"the Act"**) as well as the order dated 5th December, 2007 (for short, the **"impugned order"**) disposing of

the objections filed by the Petitioner against issuance of the impugned notice under section 148 of the Act. As a consequence, the Petitioner has also challenged the Notices dated 24th October, 2007 and 5th December, 2007 issued by the Respondent No.1 under sections 142(1) and 143(2) of the Act respectively.

2. The impugned notice under section 148 of the Act has been issued for the purpose of initiating reassessment proceedings in relation to Assessment Year 2000-2001. This Writ Petition was admitted and rule was issued by this Court on 22nd January, 2008 and interim relief was granted in favour of the Petitioner. It has now come up for hearing and final disposal before us.

3. Exception is taken to the impugned notice as well as the impugned order on the ground that the impugned notice dated 30th March, 2007 is admittedly issued after the expiry of four years from the end of the A. Y. 2000-2001 and therefore, bad-in-law for want of satisfaction of the following pre-requisite conditions :-

(a) There must be reason to believe that income chargeable to tax has escaped assessment;

(b) There must be a failure on the part of the Assessee to disclose full and truly all material facts as a result of which income has escaped assessment;

(c) The allegation of failure of the Assessee to disclose fully and truly all material facts should be in the reasons as recorded for reopening the assessment;

(d) The allegation regarding failure to disclose all material facts should be precise and unambiguous and cannot be supplemented by giving reasons either in the order disposing of the objections filed against the issuance of a notice under section 148 of the Act or in the affidavits filed in the Writ Petition; and

(e) The belief that income has escaped assessment must not be on account of a change of opinion.

According to the Petitioner, none of the aforesaid pre-

requisite conditions have been fulfilled and therefore, no reassessment proceedings could be initiated against the Petitioner for the A. Y. 2000-2001.

4. The brief facts giving rise to the present controversy are that in respect of A. Y. 2000-2001, the Petitioner filed a return of income on 27th November, 2000 by which it returned a total income of Rs.6,70,66,640/-. The said return was accompanied by a copy of the Petitioner's audited accounts for the year ending 31st March, 2000. In the return, the Petitioner has stated by way of a note that it had earned dividend income of Rs.3,38,45,293/- which was fully exempt from tax under section 10(33) of the Act. Similarly, in the profit and loss account, the Petitioner had disclosed in Schedule 'M' that it had earned dividend income of Rs.3,38,45,293/-. A statement showing details of the units purchased and redeemed by the Petitioner of mutual funds during the said year as well as the closing stock at the end of the year was also annexed to the return.

5. Thereafter, notices were issued under section

143(2) of the Act dated 27th August, 2002 and 12th November, 2002 whereby certain queries were raised by the Assessing Officer. In reply to the aforesaid notices, the Petitioner addressed a letter dated 22nd November, 2002 wherein details with reference to secured loans, IPO, share application money, dividend received, inventory etc. were forwarded to Respondent No.1. This letter as well as the details thereof can be found at page 70 read with page 134 of the paper-book.

6. Thereafter, in response to a verbal query from Respondent No.1, the Petitioner addressed a letter dated 18th December, 2002 (page 143 of the paperbook) by which the transaction of purchase and sale of mutual funds and consequential receipts of dividend was explained to Respondent No.1. The Petitioner pointed out that in the course of its regular business of share trading it made market purchases and also explored possibility of earning money through mutual funds. It pointed out that after proper analysis it had decided to make investments in equity mutual funds of Prudential ICICI, Cholamandalam Cazenove Mutual Fund as well as Reliance Capital Mutual Fund and thereafter decided to exit the said

funds at the available NAV price. The Petitioner pointed out that the transaction was a normal business transaction and also disclosed the dividend earned from the aforesaid three mutual funds.

7. After the queries raised by Respondent No.1 were answered by the Petitioner, Respondent No.1 passed an assessment order under section 143(3) of the Act dated 31st March, 2003 by which the total income of the Petitioner was assessed at Rs.6,81,54,960/-. In determining the above income, Respondent No.1 noted that the Petitioner had borrowed money to invest in mutual funds and earned dividend therefrom. He took the view that interest on the said borrowings computed at Rs.3.49 lakhs had to be disallowed under section 14A of the Act. However, he specifically noted that the Petitioner had earned dividend income of Rs.3,38,45,293/- which was exempt from tax. In this view of the matter, in the Assessment Order dated 31st March, 2003 passed under section 143(3) of the Act, Respondent No.1 specifically exempted dividend income of Rs.3,38,45,293/-, as is evident from page 150 of the paper-book.

8. In the meanwhile, a search action under section 132(1) of the Act was carried out on 23rd March, 2001 in the case of the Petitioner and block assessment proceedings were commenced against it for the period from 1st April, 1991 to 23rd March, 2001. Respondent No.1, vide his order dated 28th February 2002, directed that a special audit under section 142(2A) of the Act be conducted by one M/s Chajed Kedia and Associates, Chartered Accountants. One of the issues on which Respondent No.1 required the auditors to report was as follows:-

> *"13 – Dividend :*
> *Please obtain the details of dividend earned on securities purchased immediately before the book closure – whether such securities have been sold or continued to remain part of closing stock. The details should show name of schemes, dates of purchase and sale, dividend received and loss incurred."*

9. In response to the order dated 28th February, 2002 initiating block assessment proceedings against the Petitioner, the special auditors gave a detailed report dated 10th August, 2002 in which full details to the various queries raised by Respondent No.1 were given. One of the contentions raised by Respondent No.1 was that the units purchased by the Petitioner was only to gain dividend income. The aforesaid contention of Respondent No.1 was dealt with by the Petitioner by its letter

dated 12th August, 2003 wherein it submitted that the purchase of units of equity mutual funds were made in the ordinary course of business with a view to hedge large speculative positions taken in the market. It was pointed out that merely because dividend had been received, the basic nature of the transaction did not change colour. The Petitioner reiterated that it had correctly claimed exemption under section 10(33) of the Act in respect of the said dividend. Be that as it may, Respondent No.1 passed a block assessment order dated 26th September, 2003 under section 158BC of the Act by which he computed the total alleged undisclosed income of the Petitioner at Rs.11,50,16,300/-. With regard to the dividend earned by the Petitioner from its holdings in mutual funds, Respondent No.1 made the following observations :-

> *"During search proceedings, it was noticed that all the constituents of Nirmal Bang Group including the assessee have indulged in large scale during the block period in the act of buying dividends from mutual funds. On perusal of record, it is noted that the assessee had received dividend to the tune of Rs.8 crores during the F.Y. 2000-01 and Rs.3 crores during the F.Y. 1999-2000 through various Mutual Funds."*
>
> *"The assessee had traded in shares / securities during the year, which included the units of mutual fund. As the assessee has mitigated the loss incurred on account of sale of mutual fund units against the gains derived on sale of shares and since the purchase and sale of such units were made with the intention to procure dividend income which is exempt from tax, the assessee's representative was asked to explain as to why the said*

loss claim of Rs.3,70,36,638/- for the assessment year 2000-01 and Rs.7,50,57,205/- for the A.Y. 2001-02 on sale of mutual fund units should not be disallowed in computing the total income of the assessee."

The details of the dividend received from mutual funds were also set out in the said order.

10. As can be seen from a perusal of the block assessment order, after considering the objections of the Petitioner, Respondent No.1 took the view that the Petitioner was showing a loss on account of purchase and sale of units of mutual funds on the one hand when he was getting a similar amount of dividend which he can claim exempt from tax under section 10(33) of the Act, on the other. In this view of the matter, Respondent No.1 held that the Petitioner had entered into a transaction of "dividend stripping" and accordingly, while the dividend received by the Petitioner in the A.Y. 2000-2001 was exempt from tax under section 10(33) of the Act, the loss of Rs.3,70,36,638/- suffered by the Petitioner on the sale of the units of the three mutual funds was disallowed.

11. Being aggrieved by this block assessment order

dated 26th September 2003, the Petitioner approached the CIT (Appeals) without any success who upheld the finding of Respondent No.1 that while the dividend income was exempted under section 10(33) of the Act, the short term capital loss suffered by the Petitioner could not be allowed as a deduction.

12. Being dissatified with the order of the CIT (Appeals), the Petitioner approached the Income Tax Appellate Tribunal (for short, the **"ITAT"**). The ITAT by its order dated 28th February, 2006 allowed the appeal of the Petitioner and held that Respondent No.1 was not justified in disallowing the loss suffered by the Petitioner from the redemption of the units of the mutual funds held by it. Whilst coming to this conclusion, the ITAT followed the decision of a five member Special Bench of the Tribunal in the case of **Wallfort Shares and Stock Brokers Ltd. v/s ITO**.[1]

13. After the proceedings in relation to the block assessment of the Petitioner attained finality all the way upto the ITAT, Respondent No.1 issued the impugned notice dated

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30th March, 2007 under section 148 of the Act wherein it was stated that Respondent No.1 had reason to believe that the Petitioner's income chargeable to tax for A.Y. 2000-2001 had escaped assessment within the meaning of section 147 of the Act. Respondent No.1 accordingly directed the Petitioner to deliver to him within 30 days a return in the prescribed form for the subject Assessment Year. In reply thereto, the Petitioner by its letter dated 1st April, 2007 requested Respondent No.1 to provide the reasons for issuance of the said impugned notice. By another letter dated 26th April 2007, the Petitioner stated that the return earlier filed by it on 27th November, 2000 may be treated as having been filed in response to the said notice.

14. Instead of replying to the aforesaid letters of the Petitioner, Respondent No.1 issued a notice dated 24th October, 2007 under section 142(1) of the Act by which the Petitioner was directed to produce details of dividend received which had been claimed as exempt from tax under section 10(33) of the Act and also its books of accounts alongwith vouchers. In reply thereto and in view of the fact that no reasons had been

forwarded to the Petitioner for issuance of the impugned notice, the Petitioner by its letter dated 5th November, 2007 once again requested Respondent No.1 to furnish it a copy of the reasons recorded for issuance of the impugned notice under section 148 of the Act. Accordingly, Respondent No.1 by its letter dated 7th November, 2007 communicated the reasons to the Petitioner. This letter can be found at page 421 of the paper-book and reads as under :-

> *"No.ACIT/CC-41/Reasons/2007-08 Date: 07.11.2007*
> *To:*
> *M/s Nirmal Bang Securities Pvt.Ltd.,*
> *38 B Khatau Building, 2nd Floor,*
> *Alkesh Dinesh Mody Marg,*
> *Fort, Mumbai 400 023*
>
> *Sir,*
>
> *Sub : Reasons recorded for re-opening the assessment and issue of notice u/s 148 – A.Y. 2000-01 – reg.*
>
> *Please refer to your letter dtd. 5/11/2007 submitted during the course of hearing for reopened assessment.*
>
> *In this regard, I communicate you the reasons recorded for issuing notice u/s 148. The reasons recorded are as under :-*
>
> *It is observed from the income-tax record that the assessment of the above mentioned case has been completed u/s 143(3) on 31.03.2003. In this assessment, the assessing officer has allowed exemption u/s 10(33) claimed by the assessee on the dividend income on mutual funds as mentioned below :*
>
> | | | |
> |---|---|---|
> | *Prudential ICICI* | | *Rs. 32,77,613.90* |
> | *Cholamandalam* | | *Rs.2,50,42,686.40* |
> | *Reliance Capital* | | *Rs. 47,95,013,19* |
> | | | ---------- |
> | | *Total* | *Rs.3,31,15,313.49* |

As per the CBDT Circular No.14/2001, the definition of share as mentioned in the section 10(33) includes units of UTI or any other mutual funds. But later on, this section 10(33) was amended retrospectively by Finance Act, 2001 w.e.f. 01.04.2000 as per which, from A.Y. 2000-01 onwards, the exemption u/s 10(33) shall not apply to any income arising from the transfer of units of UTI or mutual fund. Since the assessee has earned dividend income from transfer of units of mutual funds as mentioned above, the assessee is not entitled to exemption u/s 10(33) of the I.T. Act, 1961. It is also observed that the assessee is trading in shares. The dividend income received is integral part of traded goods and cannot be segregated from the cost of the shares. For the reasons mentioned above, dividend income so earned should have been charged to tax as short-term capital gain.

Therefore, I have reasons to believe that the income of Rs.3,31,15,313.49 has been escaped for the A.Y. 2000-01."

Sd/-

ACIT, Cent.Cir.41, Mumbai."

(emphasis supplied)

15. The Petitioner thereafter by its letter dated 13th November, 2007 furnished its objections to the proposed reassessment. The grounds taken in the aforesaid letter were, in a nutshell, that the assessment order under section 143(3) had already been passed and as the period of four years had lapsed from the end of A. Y. 2000-2001, the assessment could not be reopened in the absence of any failure on the part of the Petitioner to make a full and true disclosure of the material facts. The Petitioner emphasized that it was not even the case of Respondent No.1 that there had been any failure on the part

of the Petitioner to make a true and full disclosure and therefore reassessment proceedings were without jurisdiction. It was also pointed out that reassessment proceedings were based on a mere change of opinion which was impermissible under the Act. There were also other objections that were set out in the said letter.

16. Be that as it may, Respondent No.1 passed the impugned order dated 5th December, 2007 by which he rejected the objections of the Petitioner and held that he had reason to believe that the income of Rs.3,31,15,313.49 had escaped assessment for the A.Y. 2000-01.

17. In this factual backdrop, Mr Murlidharan, learned counsel appearing on behalf of the Petitioner, submitted that admittedly in the facts of the present case, the impugned notice issued under section 148 of the Act to initiate reassessment proceedings for A. Y. 2000-2001 was beyond the period of four years. He therefore submitted that:-

(i) the condition precedent to initiate reassessment proceedings under section 148

of the Act after a period of four years from the end of the relevant assessment year was only if there was a failure on the part of the assessee to make a return under sections 139 or 142(1) or 148 of the Act or a failure to disclose fully and truly all material facts necessary for his assessment for that Assessment Year. In the present case, the reasons recorded for re-opening the assessment do not even allege that there was any failure on the part of the Petitioner to disclose truly and fully any material fact in the regular assessment proceedings;

(ii) in fact there was a full and true disclosure of all material facts necessary for assessment during the regular assessment proceedings for A. Y. 2000-2001. This was evident from the letters dated 22nd November, 2002 as well as 18th December, 2002 addressed by the Petitioner in reply to the queries by

Respondent No.1 wherein full disclosure of the mutual funds purchased by the Petitioner was made alongwith the dividend income received thereon. It is only thereafter that Respondent No.1 passed the assessment order dated 31st March, 2003 under section 143(3) of the Act;

(iii) in any event, Respondent No.1 had already considered this issue in the regular assessment proceedings leading to an assessment under section 143(3) of the Act and came to the conclusion that the dividend income received by the Petitioner from the aforesaid three mutual funds was exempt from tax under section 10(33) of the Act. Therefore the re-opening of the assessment proceedings for A. Y. 2000-2001 was merely on the basis of a change of opinion which was impermissible in law; and

(iv) in any event, re-assessment could not have

been proposed as in the present facts there could be no reason to believe that income has escaped assessment. In terms of section 10(33) as amended by the Finance Act, 2001 w.r.e.f. 1st April 2000, income received in respect of units of a mutual fund specified under clause 10(23D) of the Act were exempt from tax. In this case it is undisputed that the mutual funds in question are specified mutual funds. The proviso to the said section applies only to income arising from transfer of units of a mutual fund and not to the dividend earned by holding such units. In the present case, the Petitioner had earned dividend income by holding the units of the aforesaid three mutual funds and not by its transfer. Thus, in the face of this clear position in law, there could be no reason to believe that income chargeable to tax had escaped assessment.

18. In support of the aforesaid arguments, Mr

Murlidharan relied upon the following two judgments :-

(1) Hindustan Lever Ltd. v/s R.B. Wadkar, Assistant Commissioner of Income-Tax and others;[2] and

(2) CIT – 17, Mumbai v/s M/s K. Mohan and Co. (Exports) (Reg.).[3]

For all the aforesaid reasons, Mr Murlidharan submitted that the impugned notice dated 30th March, 2007 issued under section 148 could not be sustained and the entire initiation of re-assessment proceedings was without jurisdiction.

19. On the other hand, Mr Malhotra, learned counsel appearing on behalf of the Revenue, in support of the impugned notice, submitted as under:-

(a) the reasons recorded for initiation of re-assessment proceedings under section 148 of the Act do indicate a failure to disclose fully and truly all material facts necessary for assessment. Thus the notice is within jurisdiction. It is not necessary to specifically mention the words *"there was a failure to*

2 (2004) 268 ITR 332
3 (ITXA (L) No.2347 of 2010) decided on 1st July 2011.

disclose truly and fully all material facts necessary for assessment" in the reasons recorded. This is particularly so as on a holistic reading of the reasons recorded for re-opening the assessment for A. Y. 2000-2001, there was a failure on the part of the Petitioner to fully and truly disclose all material facts relating dividend income received by the Petitioner during the subject Assessment Year;

(b) the reassessment proceedings were rightly initiated on the basis of material facts which came to the notice of the Assessing Officer subsequent to the completion of the regular assessment proceedings under section 143(3) of the Act as mentioned in the reasons recorded for re-opening the case of the Petitioner. Thus there was a failure to disclose fully and truly all material facts necessary for assessment;

(c) as per explanation (1) to section 147 of the Act, production before the Assessing Officer of the books of accounts or other evidence from which material evidence could, with the due diligence, have been discovered by the Assessing Officer, will not necessarily amount to a disclosure within the meaning of the proviso to section 147. In the present facts it was submitted that the Petitioner has not disclosed the fact during the course of regular assessment proceedings that the dividend income was an integral part of the business and would therefore be taxable in the present case; and

(d) in the present facts there was no change of opinion as in the absence of all facts being disclosed truly and fully in the regular asssessment proceedings, there could be no formation of an opinion.

For the aforesaid reasons, Mr Malhotra submitted that there was no merit in the Writ Petition and the same ought to be dismissed.

20. We have heard learned counsel at great length and perused the papers and proceedings in the Writ Petition alongwith the annexures thereto. Section 147 of the Act deals with income escaping assessment. The said section inter alia provides that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153 of the Act assess or re-assess the said income chargeable to tax. However, this is subject to certain limitations. The first proviso to section 147 inter alia stipulates as follows :-

> *"Provided that where an assessment under sub-section (3) of section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139 or in response to a notice issued under sub-section (1) of section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment, for that assessment year."*
>
> (emphasis supplied)

21. In the present case, admittedly, the assessment had been made under section 143(3) of the Act for A.Y. 2000-2001. It is also admitted that the reassessment proceedings initiated for A.Y. 2000-2001 was after the expiry of four years from the end of the said Assessment Year. In such a scenario, as per the first proviso to section 147 of the Act, no action for initiation of reassessment proceedings for A.Y. 2000-2001 could have been taken unless the Assessing Officer had reason to believe that income chargeable to tax had escaped assessment by reason of a failure on the part of the Petitioner to disclose fully and truly all material facts necessary for assessment. As rightly submitted by Mr Murlidharan, learned counsel appearing on behalf of the Petitioner, there is not even an allegation in the said reasons that there was any failure on the part of the Petitioner to disclose truly and fully any material fact, let alone the details thereof. In fact, on a perusal of the said reasons and as reproduced above, it is clear that the reason given for initiating re-assessment proceedings under section 148 of the Act was that the exemption under section 10(33) of the Act, and which was amended retrospectively by the Finance Act, 2001 with

effect from 1st April 2000, would not apply to any income arising from the transfer of units of a mutual fund. Since the Assessee had earned dividend income from transfer of units of mutual funds, it was not entitled to exemption under section 10(33) of the Act. It was further mentioned in the said reasons that since the Petitioner was trading in shares, the dividend income received was an integral part of trading goods and could not be segregated from the acquisition of the shares. It was for these reasons and these reasons only that Respondent No.1 opined that the dividend income so earned should have been charged to tax as a short term capital gain and therefore he had reason to believe that income to the tune of Rs.3,31,15,313.49 had escaped assessment for the A. Y. 2000-2001. A bare reading of the reasons would ex-facie show that there was not even an allegation in the said reasons that there was any failure on the part of the Petitioner to disclose any material fact, let alone the details thereof, which led to any income escaping assessment. Moreover, even on a holistic reading of the reasons recorded it cannot be said that it suggests any failure on the part of the Petitioner to disclose truly and fully all material facts necessary for assessment.

22. It is now well settled that the reasons which are recorded by the Assessing Officer for re-opening an assessment are the only reasons which could be considered. No substitution or deletion is permissible. No addition can be made to those reasons and no inference can be allowed to be drawn based on reasons not recorded. The reasons which are recorded by the Assessing Officer for re-opening the assessment are the only reasons which could be considered when the formation of the belief is impugned. The requirement of recording reasons is a check against arbitrary exercise of power, for it is on the basis of the reasons recorded and those reasons alone that the validity of the notice for re-opening an assessment can be sustained. The reasons cannot be allowed to grow with age and ingenuity by devising and/or supplementing additional reasons in replies and affidavits not envisaged in the reasons recorded for re-opening the assessment. To put it simply, the validity of a notice under section 148 of the Act has to be tested on the basis of the reasons recorded for initiating the re-assessment proceedings. The reasons recorded cannot be supplemented by affidavits and other material. In this regard, Mr Murlidharan's

reliance upon the judgment of this Court in the case of **Hindustan Lever Ltd.**[2] is well founded. At pages 337 and 338, this Court held as under :-

> *"The reasons recorded by the Assessing Officer nowhere state that there was failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment of that assessment year. It is needless to mention that the reasons are required to be read as they were recorded by the Assessing Officer. No substitution or deletion is permissible. No additions can be made to those reasons. No inference can be allowed to be drawn based on reasons not recorded. It is for the Assessing Officer to disclose and open his mind through reasons recorded by him. He has to speak through his reasons. It is for the Assessing officer to reach the conclusion as to whether there was failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for the concerned assessment year. It is for the Assessing officer to form his opinion. It is for him to put his opinion on record in black and white. The reasons recorded should be clear and unambiguous and should not suffer from any vagueness. The reasons recorded must disclose his mind. The reasons are the manifestation of the mind of the Assessing Officer. The reasons recorded should be self-explanatory and should not keep the assessee guessing for the reasons. Reasons provide the link between conclusion and evidence. The reasons recorded must be based on evidence. The Assessing Officer, in the event of challenge to the reasons, must be able to justify the same based on material available on record. He must disclose in the reasons as to which fact or material was not disclosed by the assessee fully and truly necessary for assessment of that assessment year, so as to establish the vital link between the reasons and evidence. That vital link is the safeguard against arbitrary reopening of the concluded assessment. The reasons recorded by the Assessing Officer cannot be supplemented by filing an affidavit or making an oral submission, whereas, the reasons which were lacking in the material particulars would*

2 (2004) 268 ITR 332

get supplemented, by the time the matter reaches the court, on the strength of the affidavit or oral submissions advanced."

23. In fact, after relying upon the judgment of this Court in **Hindustan Lever Ltd.**[2], another Division Bench of this Court in the case of **Prashant S. Joshi v/s Income Tax Officer and another,**[4] held thus :-

> *"9. Section 147 provides that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may subject to the provisions of sections 148 to 153, 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 the section. The first proviso to section 147 has no application in the facts of this case. The basic postulate which underlies section 147 is the formation of the belief by the Assessing Officer that any income chargeable to tax has escaped assessment for any assessment year. The Assessing Officer must have reason to believe that such is the case before he proceeds to issue a notice under section 147. The reasons which are recorded by the Assessing officer for reopening an assessment are the only reasons which can be considered when the formation of the belief is impugned. The recording of reasons distinguishes an objective from a subjective exercise of power. The requirement of recording reasons is a check against arbitrary exercise of power. For it is on the basis of the reasons recorded and on those reasons alone that the validity of the order reopening the assessment cannot be allowed to grow with age and ingenuity, by devising new grounds in replies and affidavits not envisaged when the reasons for reopening an assessment were recorded. The principle of law, therefore, is well settled that the question as to whether there was reason to believe, within the meaning of*

2 (2004) 268 ITR 332
4 (2010) 325 ITR 154

> *section 147 that income has escaped assessment, must be determined with reference to the reasons recorded by the Assessing Officer. The reasons which are recorded cannot be supplemented by affidavits. The imposition of that requirement ensures against an arbitrary exercise of powers under section 148."*
>
> (emphasis supplied)

24. In view of the aforesaid well settled legal position and there admittedly being not even an allegation in the reasons recorded that there was any failure on the part of the Petitioner to disclose truly and fully any material fact necessary for assessment, let alone the details thereof, the impugned notice dated 30th March, 2007 and the impugned order dated 5th December, 2007 are liable to be quashed and set aside on this ground alone.

25. In the facts of the present case, even otherwise from the record we find that the Petitioner had disclosed fully and truly all material facts relating to the dividend income received by it. This is clear firstly from the return of income filed by the Petitioner on 27th November, 2000 where in the computation annexed to the return, the Petitioner had stated that it had earned dividend income of Rs.3,38,45,293/- which was fully exempt from tax under section 10(33) of the Act. Secondly, in

the profit and loss account, the Petitioner had disclosed by way of Schedule 'M' that it had earned dividend income of the aforesaid amount. Thus there being a full and true disclosure of all material facts relating to earning of dividend income from units of mutual funds and the claim for exemption under section 10(33) of the Act, the the impugned notice is without jurisdiction as it fails to satify the criteria as set out in the first proviso to section 147 of the Act.

26. We further find that during the assessment proceedings under section 143(3) of the Act, the Assessing officer called for particulars and sought explanations from the Petitioner specifically on the issue of the dividend income earned by the Petitioner from mutual funds. By its letters dated 22nd November, 2002 and 18th December 2002, the Petitioner furnished all the information and complied with the requisitions of the Assessing Officer. As can be seen from the letter dated 22nd November, 2002 (at page 70, read with page 134 of the paper-book), the dividend income received by the Petitioner from the aforesaid three mutual funds was clearly disclosed and specifically brought to the attention of the Assessing Officer.

After taking these disclosures into account, the Assessing Officer passed his assessment order under section 143(3) of the Act on 31st March, 2003 and which can be found at page 147 of the paper-book. In this assessment order, the Assessing Officer specifically refers to the names of the aforesaid three mutual funds, the number of units purchased by the Petitioner and the dividend received therefrom. In the computation of income, the Assessing Officer has specifically recorded that the dividend income of Rs.3,38,45,293/- is exempt from tax. It is on this basis that the total income computed by the Assessing Officer came to Rs.6,81,54,960/-. All this material would clearly show that the Assessing Officer, during the regular assessment proceedings under section 143(3) of the Act, had specifically applied his mind to the dividend income earned by the Petitioner during the A.Y. 2000-2001 and on due consideration of these facts, he passed his assessment order under section 143(3) of the Act forming an opinion that the dividend income earned by the Petitioner was exempt from tax. This would clearly establish that there was due application of mind to all relevant facts and thereafter an opinion was formed that dividend income earned from the aforesaid three mutual funds

are exempt from tax under section 10(33) of the Act. We have therefore no hesitation in holding that the initiation of re-assessment proceedings has been undertaken merely on the basis of a change of opinion. Thus, the impugned notice is not sustainable also on the ground that it proceeds on a mere change of opinion.

27. Although not strictly relevant, it may be pointed out that the very same Assessing Officer initiated block assessment proceedings against the Petitioner. Even in block assessment proceedings, the Assessing Officer accepted that the dividend income earned by the Petitioner was exempt from tax under section 10(33) of the Act. He was however of the opinion that the Petitioner had indulged in "dividend stripping" and therefore it was not entitled to claim a deduction of the loss suffered by it when it sold / redeemed the units of the aforesaid three mutual funds. As mentioned earlier, this order of the Assessing Officer in relation to block assessment proceedings was overturned by the ITAT by its order dated 28th February, 2006. It is only when the block assessment proceedings attained finality all the way upto the ITAT that the Revenue

sought to re-open the assessment for A.Y. 2000-2001. All these facts would further fortify our finding that the initiation of re-assessment proceedings for A.Y. 2000-2001 was based only on a change of opinion and which is impermissible in law.

28. We also find force in the argument of Mr Murlidharan that the Assessing Officer could have no reason to believe that the dividend income received by the Petitioner from the aforesaid three mutual funds had escaped assessment as it is exempt from tax as set out in section 10(33) of the Act. Section 10(33) as amended by the Finance Act, 2001 w.r.e.f. 1st April, 2000 reads as under:-

> ***"(33) any income by way of -***
>
> *(i) dividends referred to in section 115-O or*
>
> *(ii) income received in respect of units from the Unit Trust of India established under the Unit Trust of India Act 1963 (52 of 1963) or*
>
> *(iii) income received in respect of the units of a mutual fund specified under clause (23D);*
>
> *Provided that this clause shall not apply to any income arising from transfer of units of the Unit Trust of India or of a mutual fund, as the case may be."*

29. Section 10 of the Act falls under Chapter III and stipulates that in computing the total income of a previous year

of any person, any income falling within any of the clauses mentioned therein shall not be included. Section 10(33) provides that any income by way of (i) dividends referred to in section 115-O; or (ii) income received in respect of the units from the Unit Trust of India established under the Unit Trust of India Act, 1963; or (iii) income received in respect of units of a mutual fund specified under section 10(23D), shall be exempt from tax. The proviso to section 10(33) of the Act stipulates that this clause shall not apply to any income arising from transfer of units of the Unit Trust of India or of a mutual fund, as the case may be. On an ex-facie reading of the said provision, it is clear in the facts of the present case that the proviso to section 10(33) could never apply to the dividend income earned by the Petitioner. In the facts of the present case, dividend received by the Petitioner does not arise from the transfer of units of the mutual fund but arises by virtue of the fact that those units were held by the Petitioner. In fact, on the transfer of the units of the mutual fund, the Petitioner had sustained a loss for which it claimed a deduction which was initially disallowed by the Assessing Officer in the block assessment proceedings and which order of the Assessing Officer was

overturned by the ITAT by its order dated 28th February, 2006. We are therefore clearly of the view that the Assessing Officer could have no reason to believe that the dividend income earned by the Petitioner from the aforesaid three mutual funds had escaped assessment. As stipulated in section 10(33) of the Act, the said income was exempt and therefore could not have been brought to tax. Thus the impugned notice is also without jurisdiction as the Assessing Officer could have had no reason to believe that income chargeable to tax had escaped assessment.

30. In view of our discussion in this judgment and for the reasons stated herein, the notice issued under section 148 of the Act cannot be sustained. Rule is acordingly made absolute and the Writ Petition is granted in terms of prayer clause (a). However, in the facts and circumstances of the case, we leave the parties to bear their own costs.

(B.P.COLABAWALLA, J.) **(M.S.SANKLECHA, J.)**