(2016) 01 KAR CK 0276

In the Karnataka High Court

Case No : I.T.A. Nos. 68 of 2014 connected with 67 of 2014

Commissioner of Income-Tax APPELLANT

Vs

Saravana Developers RESPONDENT

Date of Decision : 21-01-2016

Acts Referred:
Income Tax Act, 1961 — Section 263

Citation : (2016) 289 CurTR 550 : (2016) 387 ITR 239

Hon'ble Judges : N.K. Patil and Mrs. S. Sujatha JJ.

Bench : Division Bench

Advocate : K.V. Aravind, Advocate, for the Appellant; A. Shankar and M. Lava, Advocates, for the Respondent

Final Decision : Dismissed

Judgement

Mrs. S. Sujatha J.—These appeals are filed by the Revenue under section 260A of the Income-tax Act, 1961 (the "Act" for short) assailing the common order passed by the Income-tax Appellate Tribunal (ITAT), Bangalore Bench - C relating to the assessment year 2006-07.

2. The facts in brief :-

the assessee is a firm engaged in the business of formation and development of residential layouts and sale of sites. The assessee filed a return of income of Rs. 37,34,104, subsequently, revised at Rs. 2,77,39,713. In the course of assessment proceedings, the assessee filed a revised computation of income of Rs. 37,34,104. The assessment under section 143(3) of the Act was concluded on December 31, 2008 accepting the return income of Rs. 37,34,014. The Commissioner of Income-tax (CIT) initiated proceedings under section 263 of the Act as the assessment concluded by the Assessing Officer was erroneous and prejudicial to the interests of the Revenue. An order was passed under section 263 of the Act on March 21, 2011, setting aside the assessment order and directed the Assessing Officer to adopt the work-in-progress at Rs. 3,01,65,044 instead of Rs. 1,09,29,265 adopted by the assessee. This order of the Commissioner of Income-tax was assailed by the assessee before the Income-tax Appellate Tribunal. In the meantime, pursuant to the directions of the Commissioner of Income-tax, (order under section 263 of the Act), the Assessing Officer took up assessment proceedings for assessment year 2006-07 and passed an order of assessment under section 143(3) of the Act determining the total income of the assessee at Rs. 2,29,69,433 as against the income of Rs. 37,34,014.

Aggrieved by the said order, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals), which was dismissed against which, the assessee preferred an appeal before the Income-tax Appellate Tribunal. These two cases were clubbed and heard together before the Income-tax Appellate Tribunal. The Income-tax Appellate Tribunal after considering the rival submissions made by both the parties, set aside the order under section 263 passed by the Commissioner of Income-tax dated March 21, 2011. As far as the challenge made by the assessee to the Commissioner of Income-tax order, relating to the consequential order passed giving effect to the order under section 263 of the Act, the assessee''s appeal is allowed since the order passed under section 263 of the Act is set aside by the Tribunal in the connected I. T. A. No. 620/Bang/2011.

3. Being aggrieved by the said judgment passed by the Income-tax Appellate Tribunal, the Revenue has preferred these appeals, raising the following substantial questions of law :

I. T. A. No. 67 of 2014

"1. Whether the Tribunal was correct in cancelling the order of the Commissioner of Income-tax under section 263 of the Income-tax Act as bad in law holding that it was not in accordance with the conditions prescribed under section 263 for initiation of the proceedings without appreciating that the Assessing Officer had not brought out anything on record while accepting the valuation of closing stock of work-in-progress to indicate he had applied his mind ?

2. Whether the Tribunal was correct in holding that it was right in cancelling the order under section 263 as being bad in law as it was not in accordance with the conditions prescribed in section 263 and the very initiation of the proceeding was made without appreciating the decisions of the facts on record without appreciating the decisions of the Supreme Court in the case Malabar Industrial Co. Ltd. v. CIT, (2000) 243 ITR 83(SC) and the High Courts in the cases of Addl. CIT v. Mukur Corporation, (1978) 111 ITR 312 (Guj) and CIT v. Daga Entrade Private Limited, (2010) 327 ITR 467 (Gauhati) ?"

I. T. A. No. 68 of 2014

"1. Whether the Tribunal was correct in holding that the assessment under section 143(3) read with section 263 is rendered infructuous as order under section 263 has been cancelled without appreciating that the Assessing Officer had not brought out anything on record while accepting the valuation of closing stock of work-in-progress to indicate he had applied his mind ?"

4. Learned counsel Sri K.V. Aravind, appearing for the Revenue, would contend that the Assessing Officer had blindly accepted the valuation of closing stock of work-in-progress as submitted by the assessee, without application of mind. Having noticed the same, the Commissioner of Income-tax being satisfied that the assessment order is erroneous and prejudicial to the interests of the Revenue, passed an order under section 263 of the Act, after considering the reply filed by the assessee to the show-cause notice issued under section 263 of the Act and hearing the authorised representatives of the assessee. The Tribunal failed to appreciate the fact that the closing value of work-in-progress has to be worked out based on the development charges during the year and the Assessing Officer, has brought on record that the project developed by the assessee was a single one on a contiguous land area. The assessee has not maintained any separate expenditure for the site sold and retained. As such, in the absence of any valid evidence, the action of the Assessing Officer in working out the value of work-in-progress in the assessment order after remand was justifiable. The Tribunal without appreciating the same, set aside the order passed by the Commissioner of Income-tax under section 263 of the Act, allowing the appeals filed by the assessee.

5. The learned counsel placed reliance on the judgment of the apex court in the case of Malabar Industrial Co. Ltd. v. CIT, reported in (2000) 243 ITR 83 (SC) in support of his contention that the Assessing Officer passed the order of assessment accepting the work-in-progress statement of the assessee without application of mind to the case in all perspective. The order passed by the Assessing Officer is not only an erroneous order, but, is prejudicial to the interests of the Revenue, the Revenue losing tax lawfully payable by the assessee.

6. Per contra, learned counsel Sri A. Shankar, appearing for the assessee supporting the orders passed by the Tribunal would contend that the twin test required to be satisfied for exercising the power under section 263 of the Act are :

(i) the order to be revised (assessment order) is erroneous ;

(ii) it is prejudicial to the interests of the Revenue.

However, the two conditions are not satisfied in the present case.

7. The original order passed by the Assessing Officer is in conformity with the provisions of the Act. The Assessing Officer had verified the material placed by the assessee in detail as regards the work-in-progress report. Considering the detailed explanation filed by the assessee for the queries made by the Assessing Officer, the closing work-in-progress report was. This figure of closing work-in-

progress was accepted by the Departmental authorities while concluding the assessment under section 143(3) of the Act for the assessment year 2007-08. The learned counsel pointing out the distinction between "lack of inquiry" and "inadequate inquiry" would contend that even if there was inadequate inquiry, that would not itself be a ground to the Commissioner of Income-tax to invoke section 263 of the Act, merely because he has a different opinion in the matter.

8. It is further contended that Explanation to section 263 of the Act inserted by the Finance Act, 2015 with effect from June 1, 2015, provides that the order passed without making enquiries or verification which should have been made, would be a ground for the Commissioner of Income-tax to invoke the provisions of section 263 subsequent to June 1, 2015, not relating to the assessment year in question.

9. Learned counsel also contended that the computation made by the Commissioner of Income-tax to arrive at the value of work-in-progress if considered to be correct, the same would result in declaring the profit of the assessee at 31.80 per cent, as against the net profit of more than 8 per cent, declared by the assessee. The mode of calculation adopted by the assessee is explained through the tabular chart depicting the development charges incurred for the assessment years 2005-06 to 2008-09 vis-a-vis land area sold and unsold. It is pointed out that the development charges declared by the assessee for the relevant assessment year in question, works out to Rs. 251.11 per sq. ft. whereas, the same is accepted at Rs. 299.41 by the Department for the assessment year 2007-08. The computation, if made considering the figures for the four assessment years relating to the issue of development charges, the same comes to more than Rs. 251.11 as claimed by the assessee and in any event, there is no loss to the Revenue to initiate proceedings under section 263 of the Act. In such circumstances, the Tribunal setting aside the order passed by the Commissioner of Income-tax, does not call for interference by this court.

10. In support of his contention learned counsel placed reliance on the following judgments :

(1) CIT v. Sunbeam Auto Ltd., (2011) 332 ITR 167 (Delhi) ;

(2) CTT v. D.G. Gopala Gowda, (2013) 354 ITR 501 (Karn) ;

(3) CIT v. Digital Global Soft Ltd., (2013) 354 ITR 489 (Karn) ; and

(4) CIT v. Dr. L. Narendra Prasad, I.T.A. No. 473 of 2009, disposed on 18.8.2015..

11. In the light of the above facts and rival contentions advanced by the learned counsel appearing for the parties, we have considered the questions of law raised by the Revenue.

12. The assessee firm is in the business of formation and development and sale of sites. The assessee had purchased lands measuring about 16.07 acres in survey numbers 52, 103 and 106 at Neralur, Balegaranahalli Village, Attibele

Hobli, Anekal Taluk. The firm was stated to have developed a portion of the land of about 22407 sq. ft. during the period relevant to assessment year 2005-06. Subsequently, the assessee entered into an agreement with M/s. Best Constructions for marketing the sites. The project was approved by BMRDA to an extent of 3,84,000 sq. ft. out of which the assessee had already developed and sold sites to the extent of 22,400 sq. ft. in the assessment year 2005-06 and 1,40,000 sq. ft. in the assessment year 2006-07. The Commissioner of Income-tax has invoked the provisions of section 263 of the Act only for the reason that the Assessing Officer has not spelt out in his order regarding the verification of the work-in-progress report and the reasons for accepting the valuation of work-in-progress report declared by the assessee. In this background, we have examined the case on hand with reference to the tabulation chart furnished by the assessee which reads thus :

M/s. Saravana Developers

Particulars

Asst-year

Asst.-year

Asst.-year

Asst.-year

2005-06

2006-07

2007-08

2008-09

Turnover (A)

3,365,000

44,220,398

43,882,100

11,781,000

Development charges

10,342,310

41,260,000

35,927,100

2,755,000

Add: Opening W.I.P

8,010,730

10,929,625

10,326,700

10,342,310

49,270,730

46,856,725

13,081,700

Less : Closing W.I.P

8,010,730

10,929,625

10,326,700

3,773,378

Net development charges

2,33,580

38,341,105

36,530,025

9,308,322

per cent. Profit on turnover

9.00

10.00

10.70

8.05

Land area sold (SFT)

22,400

140,400

113,557

15,240

Unsold land area (SFT)

361,600

221,200

107,643

92,403

13. The Commissioner of Income-tax while computing the closing work-in-progress for the assessment year 2006-07 has worked as under :

Total area developed during the year

3,61,600 sq. ft

Total developmental charges incurred

Rs. 4,12,60,000

Rate per sq. ft. incurred

4,12,60,000/3,61,000 = Rs. 114.10 per sq. ft

Area of unsold sites is 2,21,200 sq. ft.

Developmental charges relating to unsold sites to be taken as closing work in progress

2,21,200 x 1144.10 = Rs. 2,52,38,920

Land cost of unsold sites

Total Cost/Total land 85,55,060/3,84,000 x 2,21,200 = Rs. 49,26,124

Closing work-in-progress

Land cost + developmental charges 49,26,124 + 2,52,38,920 = Rs. 3,01,65,044

14. It is also noticed by us that the Income-tax Appellate Tribunal has called for the records of assessment of the relevant assessment year and examined the various details, questionnaire (1) called by the Assessing Officer along with notice under section 142(1) of the Act and additional details vide questionnaire (2) vis-a-vis the assessee''s reply to the said questionnaire. We have considered carefully the figures shown in the chart furnished by the assessee for the assessment years 2005-06 to 2008-09. The development charges for these four years works out to Rs. 9,02,84,410 (Rs. 1,03,42,310 + Rs. 4,12,60,000 + Rs. 35,92,700 + Rs. 27,55,000), deducting closing stock of Rs. 37,73,378, the net development charges would be Rs. 8,65,11,032. The total land area sold + unsold is 22,400 + 3,61,600 = 3,84,000 sq. ft. The total unsold area as per the assessment year 2008-09 is 92,403 sq. ft. Deducting the same from 3,84,000 sq. ft., total sold area is 2,91,597 sq. ft. Thus, the development expenses works out to Rs. 296.68 per sq. ft. (8,65,11,032/2,91,597).

15. The method of computation adopted by the assessee is as follows :

Net development expenses in respect of sites sold Rs. 3,52,56,499 (Rs. 4,12,60,000 - Rs. 60,03,501 closing work-in-progress) vis-a-vis, the sites sold of

1,40,400 sq. ft. which works out to Rs. 251.11 per sq. ft.

16. For the assessment year 2007-08, the development expenses allowed by the Assessing Officer are Rs. 3,40,01,131 relating to the sites sold of 1,13,557 sq. ft. The expenses work out to Rs. 299.41 per sq. ft. An examination of these figures as reflected in the computation made above establishes that the development charges claimed by the assessee per sq. ft. are Rs. 251.11 which is lower than Rs. 299.41 accepted by the Department for the assessment year 2007-08 while concluding the assessment under section 143(3) of the Act. One mode of computation which we have examined, stated above at para 14, works out to Rs. 296.68 per sq. ft. The development charges of Rs. 251.11 per sq. ft. claimed by the assessee are just and reasonable and do not result in any loss to the Revenue. Thus, the Commissioner of Income-tax invoking the provisions of section 263 of the Act, is uncalled for as the order passed by the Assessing Officer is no way prejudicial to the interests of the Revenue. The Revenue has miserably failed to satisfy us that the valuation of the work-in-progress accepted by the Assessing Officer, is erroneous and prejudicial to the interests of the Revenue. Yet another important aspect which is significant to notice is that the Assessing Officer, accepted the valuation of the work-in-progress of the assessee for the assessment year 2007-08, while concluding the assessment under section 143(3) of the Act. The Commissioner of Income-tax committed an error in taking the amount incurred in the current year of Rs. 4,12,60,000 and dividing it by the entire area of the project of 3,84,000 sq. ft. while computing the work-in-progress value.

17. In Sunbeam''s case (supra), the Delhi High Court placing reliance on the Judgments of the apex court in the case of Parashuram Pottery Works Co. Ltd. v. ITO, (1977) 106 ITR 1 (SC) and Malabar Industrial Co. Ltd. (supra) has held that the Commissioner having conceded the position that the Assessing Officer made enquiries, elicited replies and thereafter passed the assessment order, the grievance of the Commissioner that the Assessing Officer should have made further enquires rather than accepting the explanation and in such situation, it cannot be said that it is a case of "lack of inquiry". In this context, it is held that the opinion of the Assessing Officer in treating the expenditure as revenue expenditure was plausible and thus, there was no material before the Commissioner of Income-tax to vary that opinion and ask for fresh inquiry by invoking section 263 of the Act. The Division Bench of this court in the case of D.G. Gopala Gowda (supra) while considering the power of revision conferred under section 263 of the Act has held that the condition precedent for exercising the revisional power under section 263 of the Act is that the order under revision should not only be erroneous, but such erroneous order should result in prejudice to the interests of the Revenue. Mere error would not confer the jurisdiction to exercise the revisional power under section 263 of the Act. In the judgment of this court in the case of Digital Global Soft Ltd. (supra), considering the judgment of this court in Malabar Industrial Co. Ltd. (supra) it is categorically held that even if an order of the Assessing Officer is erroneous, unless the said

erroneous order is prejudicial to the interests of the Revenue, the Commissioner could not have exercised the suo motu revisional power under section 263 of the Act.

18. The apex court in the case of Malabar Industrial Co. Ltd. (supra) has laid down the principles in the context of section 263 of the Act. The relevant portion of para. 5 of the said judgment is reproduced below (page 87 of 243 ITR) :

"A bare reading of this provision makes it clear that the prerequisite to exercise of jurisdiction by the Commissioner of Income-tax suo motu under it, is that the order of the Income-tax Officer is erroneous in so far as it is prejudicial to the interests of the Revenue.

The Commissioner of Income-tax has to be satisfied of twin conditions, namely, (i) the order of the Assessing Officer sought to be revised is erroneous ; and (ii) it is prejudicial to the interests of the Revenue. If one of them is absent - if the order of the Income-tax Officer is erroneous but is not prejudicial to the Revenue or if it is not erroneous but is prejudicial to the Revenue - recourse cannot be had to section 263(1) of the Act.

There can be no doubt that the provision cannot be invoked to correct each and every type of mistake or error committed by the Assessing Officer, it is only when an order is erroneous that the section will be attracted. An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind.

The phrase ''prejudicial to the interests of the Revenue'' is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not (conferred) to loss of tax."

19. In the light of the judgments discussed above, we are of the firm view that the twin tests propounded by the hon''ble courts for invoking the provisions of section 263 of the Act, are not satisfied in the present case. As discussed above, the Commissioner of Income-tax proceeded to initiate proceedings under section 263 of the Act only on the ground that the Assessing Officer has not assigned any reasons for accepting the valuation of the work-in-progress declared by the assessee. As per the materials placed before the Tribunal in the records pertaining to the assessment year in question, a detailed examination is made by the Tribunal, the Tribunal is of the view that the Assessing Officer has applied his mind before accepting the figure declared by the assessee in the work-in-progress report. Such an order cannot be held to be erroneous and prejudicial to the interests of the Revenue. It is not a case of "lack of inquiry". Further inquiry ordered by the Commissioner of Income-tax would amount to fishing/rowing inquiry in the matter already concluded.

20. Learned counsel placed reliance on the judgment of this court in the case of Dr. L. hlarendra Prasad (supra) to contend that generally in the business of real

estate, the net profit would be 8 per cent, as accepted by the Department. In the present case, the profit declared by the assessee works out to more than 8 per cent, that is normally adopted and accepted by the Department. However, in the computation of work-in-progress made by the Appellate Commissioner, the profit margin works out to more than 31.8 per cent, which is practicably not acceptable. Accordingly, on this count also, we are not inclined to accept the order passed by the Commissioner of Income-tax computing the margin at more than 31 per cent, which is not normally workable in the business of real estate as pointed out by the learned counsel for the assessee and this view is also supported by the Division Bench judgment of this court in Dr. L. Narendra Prasad''s case (supra).

21. The Income-tax Appellate Tribunal having considered the material placed before it, rightly set aside the order passed under section 263 of the Act, as not sustainable. Accordingly, the assessee''s appeal is allowed as the consequential order passed under section 143(3) read with section 263 of the Act does not survive for consideration as having become infructuous. No exception can be found with the well reasoned order passed by the Income-tax Appellate Tribunal.

22. We have also noticed the amendment brought to section 263 of the Act by the Finance Act, 2015, with effect from June 1, 2015 by introducing an explanation which provides for invoking section 263 even in cases where the order is passed by the Assessing Officer is without making inquiries or verifications but the same is not applicable to the case on hand.

23. For the foregoing reasons, the substantial questions of law raised in both the appeals are answered in favour of the assessee and against the Revenue. Accordingly, the appeals stand dismissed.