

(2011) 04 GUJ CK 0150

In the Gujarat High Court

Case No : Special Civil Application No. 3994 of 2001

Devesh Metcast Ltd.

APPELLANT

Vs

Jt. CIT

RESPONDENT

Date of Decision : 11-04-2011

Acts Referred:

Constitution of India, 1950 — Article 226

Income Tax Act, 1961 — Section 143(1), 143(2), 143(3), 147, 148

Citation : (2011) 201 TAXMAN 395

Hon'ble Judges : Harsha Devani, J;B.M. Trivedi, J

Bench : Division Bench

Advocate : J.P. Shah, for the Appellant; M.R. Bhatt and Mrs. Mauna M. Bhatt, for the Respondent

Final Decision : Allowed

Judgement

Ms. Harsha Devani, J.—By this petition under article 226 of the Constitution of India, the petitioner has challenged the notice dated 28-3-2000 issued by the respondent in exercise of powers u/s 148 of the income tax Act, 1961 (the Act) for reopening the assessment for assessment year 1997-98.

2. The petitioner, a limited company, is assessed to tax under the provisions of the Act. The petitioner company filed its return of income for assessment year 1997-98 wherein it claimed set off of carried forward depreciation of Rs. 2,44,94,386 against the short-term capital gain which according to the respondent is Rs. 231.47 lakhs. Along with the return of income, the petitioner had filed relevant notes in the statement of income. The Assessing Officer accepted the claim of set off of such carried forward depreciation against short-term capital gain u/s 143(1) of the Act. Subsequently, by the impugned notice dated 28-3-2000, the respondent has reopened the assessment of the petitioner proposing to recompute the loss/depreciation allowance and asking the petitioner to file a return. The petitioner, by a letter dated 19-4-2000 requested the respondent to supply a copy of the reasons recorded by him. vide another

letter dated 27-4-2000, the petitioner reminded the respondent that no communication had been received in response to the earlier letter and stated that the original return be considered to be one filed in response to the notice u/s 148 of the Act. The respondent thereafter issued a notice dated 22-8-2000 u/s 143(2) of the Act. The petitioner, vide its reply dated 7-9-2000 informed the respondent that it had still not received a copy of the reasons and prayed for an adjournment. Though the respondent had not supplied the reasons, from the enclosure dated 8-5-2001 forwarded along with the notice issued u/s 142(1) of the Act, it was obvious as to what the section 148 notice was about because the petitioner was asked to show cause as to why the claim of set off of unabsorbed depreciation of earlier years aggregating Rs. 244.94 lakhs against short-term capital gain of Rs. 231.47 lakhs for the assessment year 1997-98 should not be disallowed as set off of unabsorbed depreciation is permissible against business income only and not against short-term capital gain, and why consequently, the taxable income should not be taken at Rs. 222.20 lakhs after adjusting current years business loss and depreciation aggregating at Rs. 9.27 lakhs. According to the petitioner, the respondent wants to disallow carried forward depreciation against short-term capital gain in the assessment year 1997-98 despite the clear law to the contrary and as such, the petitioner wrote a letter dated 11-5-2001 to the respondent stating that the notice was against the law and against the Budget Speech of the Finance Minister in Parliament on the amended section 32(2) of the Act and once again requested for a copy of the reasons recorded by him. It is the case of the petitioner that since the predecessor Assessing Officer who made the assessment u/s 143(1) accepted the position of law that for assessment year 1997-98, depreciation carried forward from earlier years can be set off against short-term capital gain of assessment year 1997-98, the present Assessing Officer was of a different opinion and had, therefore, given the notice. Being aggrieved, the petitioner has approached this court by way of the present petition challenging the aforesaid notice.

3. Mr. J.P. Shah, learned advocate for the petitioner submitted that the assumption of jurisdiction by the respondent Assessing Officer u/s 147 of the Act is invalid on the ground that in the facts of the present case, no income has escaped assessment so as to vest in the Assessing Officer the jurisdiction to reopen the assessment. It was pointed out that this is the first assessment year after sub-section (2) of section 32 of the Act came to be substituted by the Act 33 of 1996 with effect from 1-4-1997. Under sub-section (2) of section 32 of the Act as it stood prior to its substitution, if while making assessment full effect could not be given to any allowance under clause (ii) of sub-section (1) in any previous year, owing to there being no profits and gains chargeable for that previous year or owing to the profits and gains chargeable being less than the allowance, then, the allowance or part of the allowance to which effect had not been given, as the case may be, was required to be added to the amount of the allowance for depreciation for the following year and was deemed to be part of that allowance, or if there is no allowance for the previous year, be deemed to be

the allowance for that previous year and so on for the succeeding previous years. According to the learned advocate the allowance of depreciation which could not be given effect to while making the assessment for assessment year 1996-97, was deemed to be part of the allowance for depreciation for the following year, that is, assessment year 1997-98, which is the year under consideration. Thus, when sub-section (2) of section 32 came to be substituted with effect from 1-4-1997, the unabsorbed depreciation of the previous year relevant to assessment year 1996-97 and earlier years already formed part of the allowance for the previous year relevant to assessment year 1997-98. Therefore, such allowance for depreciation was the depreciation allowance for assessment year 1997-98. Hence, while computing the depreciation allowance under the substituted provisions of sub-section (2) of section 32, it was this allowance which would be the allowance for depreciation for assessment year 1997-98.

3.1 Inviting attention to the provisions of the substituted sub-section (2) of section 32 of the Act which is the relevant provision for the year under consideration, it was submitted that under clause (i) thereto, the unabsorbed depreciation allowance is required to be first set off against the profits and gains, if any, of any business or profession and assessable for that assessment year. However, if the unabsorbed depreciation cannot be wholly set off under clause (i), then under clause (ia) the amount of unabsorbed depreciation not so set off is required to be set off from the income under any other head, if any, assessable for that assessment year and in case the unabsorbed depreciation cannot be wholly set off against clauses (i) and (ia), the amount of allowance not so set off is to be carried forward to the following assessment year and shall be set off against the profits and gains, if any, of business or profession. If such unabsorbed depreciation cannot be wholly set off, such amount shall be carried forward to the following assessment year not being more than eight assessment years immediately preceding the assessment year for which the allowance was first computed. It was, accordingly, submitted that the Assessing Officer while making assessment u/s 143(1) of the Act has rightly accepted the claim of the petitioner for deduction of depreciation allowance as per the return filed by the petitioner against the income from short-term capital gain, because in view of the provisions of clause (ia) of sub-section (2) of section 32 of the Act, the petitioner was entitled to set off the unabsorbed depreciation for assessment year 1997-98 against income under any head in case where the unabsorbed depreciation could not be set off under clause (i). It was submitted that the unabsorbed depreciation of the earlier years, by virtue of the deeming provision already formed part of the allowance for the previous year relating to assessment year 1997-98, hence the action of the Assessing Officer of reopening the assessment on the ground that the petitioner was not entitled to set off the unabsorbed depreciation for assessment years 1993-94 to 1996-97 against short-term capital gains is on a misconception of the provisions of law, inasmuch as in view of the provisions of sub-section (2) of section 32 of the Act, as it stood prior to 1-4-1997, the depreciation of those assessment years already formed part of

the depreciation allowance for the previous year relevant to assessment year 1997-98 and as such, what was deducted was the depreciation allowance of assessment year 1997-98 which was permissible under the newly substituted sub-section (2) of section 32 of the-Act.

3.2 In support of his submissions, the learned advocate placed reliance upon the decision of the Madras High Court in the case of Commissioner of Income Tax Vs. Pioneer Asia Packing (P) Limited, , wherein the court had held that as a result of the amendment of section 32(2) with effect from 1-4-1997, the deeming fiction of treating the earlier years unabsorbed depreciation as the current years depreciation was removed. The period available for absorbing the unabsorbed depreciation against the profit of the succeeding years was limited to eight years. Reliance was also placed upon the decision of the Madras High Court in the case of Commissioner of Income Tax Vs. RPIL Signalling Systems Ltd., , wherein the court had held that the unabsorbed depreciation brought forward as on 1-4-1997 could be set off against the taxable business profit or income under any other head for the assessment year 1997-98 and seven subsequent years.

3.3 Mr. Shah further submitted that apart from the fact that sub-section (2) of section 32 of the Act itself is very clear, the said provision has also been explained by the Finance Minister in the Budget Speech in the Parliament on amended section 32(2) which has been further clarified by the Central Board of Direct Taxes vide Circular No. 762 whereby it had been explained that sub" section (2) of section 32 as it existed up to assessment year 1996-97 provided that unabsorbed depreciation of a year shall be added to the amount of allowance for depreciation of the following previous year and deemed to be part of that allowance. Therefore, the unabsorbed depreciation allowance, if any, of assessment year 1996-97 shall be added to the amount of the allowance for depreciation of assessment year 1997-98 and deemed to be part of the allowance for the said year. In other words, the unabsorbed depreciation allowance of assessment year 1996-97 shall be added to the allowance of 1997-98 and will be deemed to be the allowance of that year. The limitation of eight years shall start from the assessment year 1997-98. It was submitted that the CBDT Circular being binding on all revenue officers, the respondent Assessing Officer is also bound by the same and cannot take a stand contrary to the said Circular. In support of his submissions, the learned advocate placed reliance upon the decision of the Supreme Court in the case on Navnitlal C. Javeri Vs. K.K. Sen, Appellate Assistant Commissioner of Income Tax, "D" Range, Bombay, , for the proposition that circulars issued by the Central Board of Revenue would be binding on all officers and persons employed in the execution of the income tax Act. Reliance was also placed upon the decision of the Supreme Court in the case of Union of India and Another Vs. Azadi Bachao Andolan and Another, , for the proposition that circulars issued by the Central Board of Direct Taxes are binding on the revenue authorities.

3.4 Mr. Shah next submitted that for the purpose of invoking jurisdiction u/s 147

of the Act, the first and foremost requirement is that income chargeable to tax should have escaped assessment. It was submitted that in the facts and circumstances narrated hereinabove, the petitioner was duly entitled to set off the unabsorbed depreciation for assessment year 1997-98 in terms of clause (ia) of section 32(2) of the Act against any head of income in case it could not be set off under clause (i). Hence, there being no error in the assessment u/s 143(1) of the Act, no income chargeable to tax can be said to have escaped assessment so as to vest in the Assessing Officer the jurisdiction to reopen the assessment u/s 147 of the Act. It was, accordingly, urged that the petition be allowed by setting aside the impugned notice.

4. Vehemently opposing the petition, Mr. M.R. Bhatt, learned senior advocate appearing on behalf of the respondent, submitted that earlier the assessment having been made u/s 143(1) of the Act, it cannot be said that the Assessing Officer has expressed any opinion, hence, the contention regarding change of opinion is misconceived. Reliance was placed upon the decision of the Supreme Court in the case of Assistant Commissioner of Income Tax Vs. Rajesh Jhaveri Stock Brokers Pvt. Ltd., , for the proposition that there being no assessment u/s 143(1) of the Act, the question of change of opinion does not arise.

4.1 Next, it was submitted that assuming that there is some mistake in recording the reasons, this court in a writ petition under Article 226 of the Constitution of India cannot go into the question of sufficiency of reasons at the time of challenge to a notice u/s 148 of the Act. Reliance was placed upon a decision of this High Court in the case on Praful Chunilal Patel Vs. M.J. Makwana, Assistant Commissioner of Income Tax, , for the proposition that the word reason in the phrase reason to believe would mean cause or justification. If the Assessing Officer has a cause or justification to think or suppose that income has escaped assessment, he can be said to have a reason to believe that such income has escaped assessment. The words reason to believe cannot mean that the Assessing Officer should have finally ascertained the facts by legal evidence. Unless the ground or the material on which his belief is based, is found to be so irrational as not to be worthy of being called a reason by any honest man, his conclusion that it constitutes a sufficient reason, cannot be overruled. If the Assessing Officer honestly comes to a conclusion that a mistake has been made, it matters nothing. So far as his jurisdiction to initiate the proceedings u/s 147 is concerned, though he may have come to an erroneous conclusion whether on law or on facts, the court will not, in exercise of its extraordinary jurisdiction under the Constitution, examine the sufficiency of the reasons which led the Assessing Officer to believe that the income has escaped assessment.

4.2 Mr. Bhatt submitted that the language of sub-section (2) of section 32 of the Act is clear and unambiguous, namely that when depreciation allowance for any previous year cannot be give effect to under clause (it) of sub-section (1) of section 32 of the Act, under clause (i) of sub-section (2) of section 32, the same can be set off against profits and gains of any business or profession carried on

by him. In case, it is not possible to wholly set off such unabsorbed depreciation against profits and gains of business or profession, under clause (ia) of sub-section (2) the same can be set off against income under any other head. However, if it is not possible to set off the same under either, under clause (ii) of sub-section (2) the same can be carried forward to the following assessment year and set off against profits and gains of any business or profession up to a period of eight years. Thus, if in the first year, it is not possible to set off the unabsorbed depreciation against the profits and gains of business or profession or under any other head of income, in subsequent years, such unabsorbed depreciation can be set off only against profits and gains from business or profession, and as such, the petitioners would not be entitled to set off the carried forward unabsorbed depreciation allowance of assessment years 1993-94 to 1996-97 against income from short-term capital gains.

4.3 Attention was invited to sub-section (2) of section 32 of the Act as it stood prior to 1-4-1997, to submit that the same was subject to the provisions of sub-section (2) of section 72 and sub-section (3) of section 73 of the Act. Referring to the provisions of sub-section (2) of section 72, it was submitted that in view of the said provision, where any allowance or part thereof is, under sub-section (2) of section 32 to be carried forward, effect is first required to be given to the provisions of section 72 and as such, what is handed over on 1-4-1997 is as per the provisions of sub-section (2) of section 72 of the Act.

4.4 In support of his submissions, Mr. Bhatt placed reliance upon a decision of the Delhi High Court in the case of Great Eastern Exports Vs. The Commissioner of Income Tax, , for the proposition that the law on interpretation is clear. If the language of the statute is plain and can be of one and only one meaning, that obvious meaning is to be given to the said provision. Rules of interpretation are applied only if there are ambiguities. When the purpose of interpretation is to ascertain the intention of the law, that is, mens legis, it is based on assertion by adopting a plain meaning of the statute in the absence of any ambiguity. It was submitted that in the present case there being no ambiguity in the statutory provisions, reliance placed upon the Circular which is only an explanatory note is misconceived. It was submitted that in any case, the said argument would be available to the petitioner even before the Assessing Officer. That assumption of jurisdiction u/s 147 of the Act cannot be challenged on the basis of explanatory notes. In conclusion, it was submitted that even assuming that there is a mistake in recording the reasons, if the Assessing Officer honestly believes that income has escaped assessment, this court in exercise of powers under article 226 of the Constitution of India would not ordinarily interfere. It was urged that in the aforesaid premises, the Assessing Officer was justified in reopening the assessment.

4.5 Dealing with the contention regarding the binding effect of the CBDT Circular, it was submitted that the same is only in the nature of an explanatory note which, at best, can be taken as an aid to interpreting the provisions of section

32(2) of the Act but would not override the provisions of section 32(2) of the Act. It was submitted that since the dispute involves interpretation of a statutory provision, the same be left to the Assessing Officer to decide the same in accordance with law and this court in exercise of powers under Article 226 of the Constitution of India may not interfere at this stage.

5. In rejoinder, Mr. J.P. Shah, learned advocate for the petitioner invited attention to the provisions of sub-section (2) of section 72 of the Act to submit that the said provision only provides for giving priority to carry forward losses while granting deduction because prior to the amendment, losses could be carried forward for a period of eight years only whereas the unabsorbed depreciation could be carried forward indefinitely. Thus, all that the said sub" section provides is that depreciation can be set off only after loss is set off. It was further submitted that the Circular as well as the Prime Ministers Speech only state what is already provided under sub-section (2) of section 32 of the Act. In the circumstances, the assessment cannot be reopened on an erroneous interpretation of a statutory provision, despite there being a CBDT Circular explaining the same.

6. The facts are not in dispute. In the case of the petitioner, earlier, assessment was made u/s 143(1) of the Act for the assessment year 1997-98. Subsequently, by the impugned notice issued on 28-3-2000 the assessment for assessment year 1997-98 is sought to be reopened. Since no assessment has been framed u/s 143(3) of the Act, the only requirement for initiating proceedings u/s 147 of the Act, by issuing notice u/s 148 of the Act, is that the Assessing Officer should have reason to believe that income chargeable to tax has escaped assessment, which should be recorded by him in writing prior to issuance of the notice. Since the belief is that of the Assessing Officer, the sufficiency of the reasons for forming such belief, is not for the court to judge but it is for the assessee to establish that there, in fact, existed no belief or that the belief was not at all a bona fide one or was based on vague, irrelevant and non-specific information. To that limited extent, the court may look into the conclusion arrived at by the Assessing Officer and examine whether there was any material available on record from which the requisite belief could be formed by the Assessing Officer and further whether that material had any rational connection or a live link with the formation of the requisite belief (see M/s. Phool Chand Bajrang Lal and another Vs. Income Tax Officer and another, .

7. This is a case of reopening of an assessment made u/s 143(1) of the Act. Hence, as has been rightly contended by the learned counsel for the respondent and as held by the Supreme Court in the case of Rajesh Jhaveri Stock Brokers (P.) Ltd. (supra), there would be no question of any change of opinion. In the present case, for the purpose of assuming jurisdiction u/s 147 of the Act, the only condition precedent is that income chargeable to tax should have escaped assessment. Hence, the scope of the present petition lies in a very narrow compass and all that the court is required to examine is as to whether there was

any material for the Assessing Officer to form the belief that income chargeable to tax has escaped assessment.

8. Examining the facts of the present case in the light of the aforesaid legal position, it may be necessary to refer to the reasons recorded by the Assessing Officer for reopening the assessment which read thus:-

Reasons for reopening the case

In this case, assessment of the assessee company for the assessment year 1997-98 was completed at a loss of Rs. 24.22 lakhs u/s 143(1)(a). The returned income included short-term capital gain at Rs. 231.47 lakhs which was allowed to be set off against unabsorbed depreciation aggregating Rs. 244.94 lakhs relating to assessment years 1993-94 to 1996-97. The assessee had current years business loss of Rs. 4.41 lakhs and depreciation of Rs. 4.87 lakhs. Since the set off of unabsorbed depreciation is permissible only against profit & gains of business or profession of subsequent years, allowance of set off of unabsorbed depreciation relating to earlier years against short-term capital gain is not proper. After adjusting current years business loss and depreciation aggregating Rs. 9.27 lakhs total taxable income works out to Rs. 222.20 lakhs which should have been brought to tax. Omission to do so has resulted in the escapement of income by Rs. 222.20 lakhs with consequent short levy of tax and interest.

In view of the above, assessment is reopened u/s 147 by issue of notice u/s 148 of the I.T. Act.

Issue Notice u/s 148 accordingly.

9. The reasons recorded indicate that the Assessing Officer has reopened the assessment on the ground that the petitioner had set off unabsorbed depreciation aggregating Rs. 244.94 lakhs relating to assessment years 1993-94 to 1996-97 and that it was permissible to set off unabsorbed depreciation only against profit and gains of business or profession of subsequent years and as such, the allowance of set off of unabsorbed depreciation relating to earlier years against short-term capital gain was not proper. The Assessing Officer has, therefore, formed a belief that income chargeable to tax has escaped assessment as according to him the petitioner is not entitled to set off the unabsorbed depreciation relating to assessment years 1993-94 to 1996-97 while computing the income for assessment year 1997-98.

10. Since the present petition involves the interpretation of the provisions of sub-section (2) of section 32 as introduced vide Finance (No. 2) Act, 1996 with effect from 1-4-1997, it may be germane to reproduce sub-section (2) of section 32 as it stood prior to 1-4-1997 as well as, as it stood after the same came to be substituted vide the Finance (No. 2) Act, 1996. Sub-section (2) of section 32 as it stood prior to 1-4-1997 reads thus:-

(2) Where, in the assessment of the assessee, full effect cannot be given to any allowance under clause (ii) of sub-section (1) in any previous year, owing to

there being no profits or gains chargeable for that previous year, or owing to the profits or gains chargeable being less than the allowance, then, subject to the provisions of sub-section (2) of section 72 and sub-section (3) of section 73, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following previous year and deemed to be part of that allowance, or if there is no such allowance for that previous year, be deemed to be the allowance for that previous year, and so on for the succeeding previous years.

Sub-section (2) of section 32 as substituted by Finance (No. 2) Act, 1996 with effect from 1-4-1997 insofar as the same is relevant for the purpose of the present petition reads thus:-

(2) Where in the assessment of the assessee full effect cannot be given to any allowance under clause (iii) of sub-section (1) in any previous year owing to there being no profits or gains chargeable for that previous year or owing to the profits or gains being less than the allowance, then, the allowance or the part of allowance to which effect has not been given (hereinafter referred to as unabsorbed depreciation allowance), as the case may be,-

(i) shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;

(ia) if the unabsorbed depreciation allowance cannot be wholly set off under clause (i), the amount not so set off shall be set off from the income under any other head, if any, assessable for that assessment year;

(ii) if the unabsorbed depreciation allowance cannot be wholly set-off under clause (i) and clause (ia), the amount of allowance not so set off shall be carried forward to the following assessment year and-

1. it shall be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year;

2. if the unabsorbed depreciation allowance cannot be wholly so set off, the amount of unabsorbed depreciation allowance not so set off shall be carried forward to the following assessment year not being more than eight assessment years immediately succeeding the assessment year for which the aforesaid allowance was first computed.

11. On a plain reading of sub-section (2) of section 32 of the Act as it stood prior to 1-4-1997, it is apparent that under the said provision the allowance which is permitted by way of depreciation in the current year will be adjusted against the profits and gains of the business in which the depreciation is allowed, and if the depreciation is more than the profits or gains of that business, it will be available for adjustment against the profits and gains of any other business or profession. It may, however, happen that even after adjustment of the depreciation allowance against the profits and gains of the totality of the business carried on by the assessee, there is still some surplus left over. Such surplus will be

available for being set off against the profits and gains from any other head of income. If after setting off against the income from other heads also there is still a surplus left, such surplus is to be taken to the following year and added to the allowance for depreciation for the following year and deemed to be part thereof and so on for the succeeding year. Under the terms of sub-section (2) of section 32, the unabsorbed depreciation taken to the following year, becomes a part of the depreciation allowance for the following year. It may be observed that as a result of this provision, the unabsorbed depreciation for a particular year becomes, by legal fiction, part of the allowance for depreciation for the succeeding year.

12. Thus, in the light of the provisions of sub-section (2) of section 32 of the Act as it stood prior to 1-4-1997, any unabsorbed depreciation allowance which could not be given effect to in the previous year, was required to be added to the allowance for depreciation for the following previous year and was deemed to be part of the allowance of that year. In the circumstances, insofar as the unabsorbed depreciation for assessment years 1993-94 to 1996-97 is concerned, in each of the years, the part of the allowance which could not be given effect to in any previous year, was added to the amount of allowance for depreciation for the following previous year and was deemed to be part of the allowance of that previous year. In the circumstances, once the unabsorbed depreciation allowance was for a particular assessment year, deemed to be the allowance for the following previous year, it ceased to have any independent existence. The unabsorbed depreciation allowance for assessment years 1993-94 to 1996-97, by operation of the provisions of sub-section (2) of section 32 as it stood prior to 1-4-1997 was deemed to be part of the allowance for the previous year relevant to assessment year 1997-98. Hence, for all intents and purposes, the unabsorbed depreciation for assessment years 1993-94 to 1996-97 was deemed to be the depreciation allowance for assessment year 1997-98. Subsequently, sub-section (2) of section 32 of the Act came to be substituted with effect from 1-4-1997 by the Finance (No. 2) Act, 1996.

13. According to section 32(2) as substituted where in the assessment of the assessee, full effect cannot be given to any allowance under clause (ii) of sub-section (1) in any previous year (i) owing to there being no profit or gains chargeable for that previous year or (it) owing to the profits and gains being less than the allowance, then, the allowance or part of the allowance to which effect has not been given (unabsorbed depreciation allowance) as the case may be, shall be dealt with as follows:

Such unabsorbed depreciation allowance, shall (as provided under clause (i)) be set off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year; and

The amount of unabsorbed depreciation allowance which cannot be wholly set off under clause (i) shall be set off from the income under any other head, if any, assessable for that assessment year (as provided under clause (id));

If the amount of unabsorbed depreciation allowance is not wholly set off under clauses (i) and (ia), then the amount not so set off shall be carried forward to the following assessment year; and

It shall be set off against the profits and gains if any, of any business or profession carried on by him and assessable for that assessment year;

If the amount of unabsorbed depreciation allowance is not so set off, the same shall be carried forward to the next assessment year, not being more than eight assessment years immediately succeeding the assessment year for which the aforesaid allowance was first computed.

14. Thus, by the substituted sub-section (2) of section 32 of the Act, the change which is brought in is that the earlier years unabsorbed depreciation being deemed to be part of the depreciation of the following previous year is no longer continued. Moreover, earlier the unabsorbed depreciation could be carried forward indefinitely, whereas in the light of the amended provision, the unabsorbed depreciation can be carried forward for a period of eight years immediately succeeding the assessment year for which the said allowance is first computed. However, insofar as the first year when the provision comes into operation, namely as on 1-4-1997, the unabsorbed depreciation would be the unabsorbed depreciation for the previous year relating to assessment year 1997-98, which as noticed hereinabove, by operation of the provisions of sub-section (2) of section 32 as it stood prior to 1-4-1997 included the unabsorbed depreciation of the earlier assessment year which, in the present case, relates to assessment years 1993-94 to 1996-97. In the circumstances, while making the assessment of the petitioner u/s 143(1) of the Act, the Assessing Officer had rightly accepted the return filed by the petitioner and permitted the petitioner to set off the unabsorbed depreciation against the short-term capital gains. According to the respondent, the petitioner was not entitled to set off the unabsorbed depreciation for assessment years 1993-94 to 1996-97 against short-term capital gains. However, the respondent Assessing Officer has over" looked the fact that in the light of the operation of sub-section (2) of section 32 as it stood prior to 1-4-1997, the unabsorbed depreciation of assessment years 1993-94 to 1996-97 already formed part of the depreciation allowance for the previous year relevant to assessment year 1997-98 when the substituted provision came into effect. The aforesaid interpretation is clarified by the Finance Minister in his Speech which is reproduced in paragraph 5 of the petition and reads thus:-

Clause 11 of the Bill seeks to amend section 32 of the income tax Act, 1961 relating to depreciation. During the course of discussion on the General Budget, a number of Hon"ble members have expressed their apprehension that the proposed amendment limiting carry forward of unabsorbed depreciation to 8 years will adversely affect the growth of industry. Similar apprehensions have been raised in a larger number of post-budget memoranda. I would like to allay these fears. The proposed amendment is only prospective inasmuch as the

cumulative unabsorbed depreciation brought forward as on 1-4-1997, can still be set off against taxable business profits or income under any other head for the assessment year 1997-98 and seven subsequent assessment years. Therefore, the proposed change will have effect only after 8 years and there is no cause for immediate concern about its likely impact on industry. Eight years is a period long enough for industry to adjust itself to the new dispensation and provide for depreciation accordingly. A number of Hon"ble members have brought to my notice that the proposed amendment may adversely affect sick companies. I accept the suggestions made by them. I, therefore, propose to provide that the time-limit of 8 years shall not apply to sick companies, during the period the company is treated as a "sick company" under the Sick Industrial Companies (Special Provisions) Act, 1985.

(Emphasis italicised in print supplied)

The CBDT also by Circular No. 762 has clarified the aforesaid position in the following terms:-

23.3 Sub-section (2) of section 32 provides for carry forward of unabsorbed depreciation allowance. Under this sub-section, where full effect cannot be given to the depreciation allowance in any previous year, owing to the profits or gains chargeable being less than the allowance, the allowance or part thereof to which effect has not been given shall be added to the amount of allowance for depreciation for the following previous year and deemed to be part of that allowance for that previous year, and so on for the succeeding previous years. The net effect is that unabsorbed depreciation allowance of one year is added to the depreciation allowance of the next year. Thus, the unabsorbed depreciation allowance, in a case where profits are insufficient in the subsequent years, is carried forward indefinitely. On the other hand, the business losses are allowed to be carried forward for a period of eight years only. By an amendment the business loss and the unabsorbed depreciation have been brought at par for the purposes of set off and carry forward notwithstanding the fact that sub-section (2) of section 72 maintains a distinction between them regarding the priorities.

23.5" Sub-section (2) of section 32, as it existed up to assessment year 1996-97, provided that the unabsorbed depreciation of a year shall be added to the amount of the allowance for depreciation of the following previous year and deemed to be part of that allowance. Therefore, the unabsorbed depreciation allowance, if any, of assessment year 1996-97 shall be added to the amount of the allowance for depreciation of assessment year 1997-98 and deemed to be part of the allowance for this year. In other words, the unabsorbed depreciation allowance of assessment year 1996-97 shall be added to the allowance of 1997-98 and will be deemed to be the allowance of that year. The limitation eight years shall start from the assessment year 1997-98.

23.6" These amendments take effect from the 1-4-1997, and will, accordingly, apply in relation to assessment year 1997-98 and subsequent years.

15. Thus, the Finance Ministers Speech and the CBDT Circular merely clarify the statutory provisions as they stand. It is true, as contended by the learned counsel for the respondent, that there is no ambiguity in the provisions of sub-section (2) of section 32 of the Act. However, the Assessing Officer appears to have misconstrued the provisions of sub-section (2) of section 32 and accordingly seeks to reopen the assessment based on such misconception of the statutory provision.

16. Insofar as the reference to sub-section (2) of section 72 of the Act on which reliance had been placed upon by the learned counsel for the respondent is concerned, section 72(2) only gives priority to setting off of carried forward loss as against unabsorbed depreciation, presumably in light of the fact that prior to the amendment, losses could be carried forward for a period of eight years only whereas unabsorbed depreciation could be carried forward indefinitely. The said provision does not prescribe the manner in which unabsorbed depreciation allowance is to be computed under sub-section (2) of section 32 of the Act and as such, reliance placed upon the said provision is misconceived.

17. As submitted by the learned counsel for the respondent, it may be that the Assessing Officer has reopened the assessment under an honest belief that income chargeable to tax has indeed escaped assessment, however, if such honest belief is entertained on an erroneous interpretation of the relevant statutory provisions, the assessee should not be required to face the rigours of reassessment merely because the Assessing Officer entertains an honest belief. Such honest belief should be based upon the material on record and should, in fact, give rise to the belief that income has escaped assessment. In the facts of the present case as discussed hereinabove, no income can be stated to have escaped assessment so as to vest in the Assessing Officer the jurisdiction to reopen the assessment u/s 147 of the Act.

18. In the light of the aforesaid discussion, it is not possible to state that any income chargeable to tax has escaped assessment as is sought to be contended on behalf of the respondent Assessing Officer who has reopened the assessment on the ground that the unabsorbed depreciation for assessment years 1993-94 to 1996-97 could not be set off against short-term capital gain in the year under consideration. The reopening by the Assessing Officer is based upon an erroneous interpretation of the provisions of sub-section (2) of section 32 of the Act, and in fact, as discussed hereinabove, no income chargeable to tax can be stated to have escaped assessment. The very assumption of jurisdiction by the Assessing Officer u/s 147 of the Act is, therefore, invalid. The impugned notice u/s 148 of the Act, therefore, cannot be sustained.

19. For the foregoing reasons, the petition succeeds and is accordingly allowed. The impugned notice dated 28-3-2000 seeking to reopen the assessment of the petitioner for assessment year 1997-98 (Exh.B to the petition) is hereby quashed and set aside. Rule is made absolute accordingly with no order as to costs.