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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ **INCOME TAX APPEAL NO. 447/2013**

Date of decision: 13th August, 2014

GLOBUS INFOCOM LTD

..... Appellant

Through Mr. S. Krishnan, Advocate.

versus

COMMISSIONER OF INCOME TAX DELHI-IV

..... Respondent

Through Mr. Kamal Sawhney, Sr. Standing
Counsel & Mr. Sanjay Kumar, Jr. Standing
Counsel.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J. (ORAL):

Counsel for the respondent-Revenue has not been able to ascertain the correctness of the documents filed along with the present appeal. We are not inclined to grant any further time to the counsel for the respondent-Revenue as notice in the appeal was issued on 28th October, 2013 and sufficient time has been granted. Further, a very limited issue arises for consideration.

2. By order dated 28th July, 2014, the following substantial question of law was framed:-

“Whether the Income Tax Appellate Tribunal was right



in sustaining the order dated 29.2.2012 of the Commissioner of Income Tax under Section 263 of the Income Tax Act, 1961?”

3. The present appeal by the appellant-assessee relates to the Assessment Year 2007-08. The appellant-assessee had filed return declaring income of Rs.1,82,68,953/- under normal provisions and book-profit of Rs.9,85,25,142/-. Tax was payable on book profits as per Section 115JB of the Income Tax Act, 1961 (“Act”, for short). The aforementioned return was taken up for scrutiny and additions of Rs.1,00,500/- and Rs.1,17,141/- on substantive basis, and Rs.10 lacs on protective basis, were made. Income was computed under Section 115JB at Rs.9,85,25,142/-.

4. Commissioner of Income Tax issued a notice under Section 263 of the Act, dated 4th February, 2011, on two grounds. Firstly, commission of Rs.69,53,949/- had been paid to the two Managing Directors, but should have been disallowed under Section 36(1)(ii) of the Act. Secondly, the assessee had booked majority of the expenses against the unit carrying out trading operations and thereby had inflated profits of the manufacturing unit exempt under Section 80-IC. Expenses booked for the eligible unit under section 80-IC were only Rs.12,31,78,274/-, as against expenses of Rs.37,26,60,316/- booked against trading activities.

5. The appellant-assessee filed a detailed reply, which we will be subsequently referring and are not reproducing herein to avoid prolixity.



6. The Commissioner of Income Tax, in its order dated 29th February, 2012, took note of the reply filed, which was reproduced in detail. Thereafter, in paragraph 3, he referred to the commission paid to Manish Dham and Rajive Bakshi of Rs.12,30,459/- and Rs.57,23,490/-, respectively. He took note of the submissions made by the appellant-assessee that Manish Dham was neither a shareholder nor a Director or Managing Director of the company. Further, Rajive Bakshi was controlling affairs of the manufacturing unit and due to his efforts, the appellant-assessee had achieved turnover of Rs.20.60 crores in the second year of its operation. Commission paid was duly approved by the shareholders of the company and thus Section 36(1)(ii) was not applicable. Rejecting the said contention, the Commissioner of Income Tax in his order observed:-

“4. As per Section 36(1)(ii) of IT Act, it has been provided that the admissible deduction is of any sum paid to an employee as bonus or commission for services had not been paid as bonus or commission. This section has been specifically laid down to ensure that the companies do not avoid tax by distributing their profit to their members/shareholders as bonus or commission instead of dividend. From the submissions of the Ld. A/R of the assessee company, it is not clear as to whether the concerned directors of the company were shareholders/stake holders entitled to profits or dividend of the company and accordingly, it is not possible to comment as to whether mischief of section 36(1)(ii) of IT Act is attracted towards the payment of commission to such directors. As a result, the assessment made by the AO accepting such commission payment without verifying as to whether provisions of section 36(1)(ii)



are attracted, is set-aside on this limited issue with a direction to the AO to verify as to whether the concerned directors were stake holders/shareholders in the company, entitled to profits/dividend of the company and if these facts appear to be correct then the provisions of Section 36(1)(ii) may be invoked to disallow the commission payment made to the said directors and the fresh assessment order u/s143(3) of I.T. Act may be passed accordingly.”

(emphasis supplied)

7. On the second issue, the Commissioner of Income Tax referred to the total figure of expenses claimed against the manufacturing unit and the expenses booked against trading activities. In paragraph 5 the Commissioner accepted that during the course of the assessment proceedings, a specific query was raised by the Assessing Officer to justify the expenses claimed unit-wise and the appellant-assessee had filed a letter dated 17th August, 2009 to explain allocation of common expenditure. The appellant-assessee had submitted that common expenses had been divided between the two units as per accepted accountancy principles, which were consistently followed. That appellant-assessee had maintained regular books of accounts for the exempt unit and such books of accounts along with the vouchers were duly produced and verified by the Assessing Officer, who did not point out any defects in the same. In paragraph 6, the Commissioner duly noticed break up of different expenses and apportionment thereof. The Commissioner observed that the segregation of common expenses had been made by-and-large on basis of the



manufacturing and trading operations, but he observed that as separate books of accounts for both manufacturing and trading units were maintained, then what was the need for segregating the common expenses between the trading and manufacturing operations? Reasoning and grounds given by the Commissioner on the second aspect read as under:-

“...t is quite possible that there may have been attempt to inflate the expenses for trading activity in order to show less profit from such activity eligible to tax. On the other hand, since the profit from manufacturing activity is exempt from tax u/s 80-IC of IT Act, the assessee company may have made an attempt to reduce the actual expenses on manufacturing activity in order to pass the same to trading activity for tax evasion. Therefore, the assessment order passed by the AO by accepting the claim of expenses under manufacturing and trading activity as indicated by the assessee is erroneous and consequently, prejudicial to the interest of revenue and accordingly such assessment order is set-aside on this limited issue with a direction to the AO to cause sufficient inquiries in order to ascertain the actual expenses relatable to the manufacturing and trading activity separately and allow the claim of such expenses after due verification.”

8. The appellant-assessee was maintaining separate books of accounts for the manufacturing unit receipts and expenditure which was exempt under Section 80-IC; and the trading activities. However, there were certain common expenses, which were to be segregated. Common expenses were/are not unusual, abnormal or unique in such cases. In order to carry out the said segregation, the appellant-assessee had made apportionment and the ratio thereof was indicated and informed to the



Assessing Officer. The details of the said apportionments are reproduced

below:-

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<u>S. No</u>	<u>Particulars</u>	<u>Total Expenses During the Year</u>	<u>Apportioned to Trading activities</u>	<u>Apportioned to manufacturing activities</u>	<u>Apportionment Ratio</u>	<u>Basis</u>
1	Freight & Cartage Outward	169,360	101,616	67,744	60%:40%	Majorly on sales
2	Directors Remuneration	6,462,600	4,253,820	2208780	65%:35%	Strictly on sales
3	Insurance Exps	418,805	336,643	82,162	80%:20%	On Insurance one on Import of goods
4	Printing & Stationery	2,265,717	1,586,002	679,715	70%:30%	Majorly on sales
5	Travelling Exps Director	787,425	544,799	242,626	70%:30%	Majorly on sales
6	Travelling Expenses-Foreign	2,859,164	2,529,078	330,086	88%:12%	On Imports
7	Interest on Vehicle Loans etc.	1,075,025	752,518	322,508	70%:30%	Majorly on sales
8	Advertisement Exps	188,377	128,364	60,013	70%:30%	Majorly on sales
9	Sales Promotion	1,875,257	1259,516	615,741	70%:30%	Majorly on sales
10	Incentive to Staff	705,607	493,925	211,682	70%:30%	Majorly on sales
11	Car Hiring Chg.	688,075	456,501	231,574	65%:35%	Strictly on sales
12	Legal & Professional Charges	2,890,732	1,900,002	990,730	65%:35%	Strictly on sales
13	Testing & Inspections	301,444	190,720	110,724	65%:35%	Strictly on sales



	Total	20,687,588	14,533,502	6154,086		
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The aforesaid figures stand reproduced in the order passed by the Commissioner.

9. The Commissioner, instead of commenting upon or giving a final finding whether aforesaid apportionment was acceptable or not, observed that it was possible that there was an attempt to inflate expenses on trading activity and an attempt might have been made to reduce actual expenses of the exempt unit. The use of the word “possible” would indicate that there was no finding and adjudication by the Commissioner and his observations were based on mere suspicion and certainly uncertain. Yet, the Commissioner proceeded further and figmented that this would mean that the Assessing Officer had passed an erroneous order and consequently it was prejudicial to the interest of the Revenue. Direction was issued to the Assessing Officer to carry out fresh inquiries to do the exercise once again and decipher whether the actual expenses relatable to the manufacturing and trading activities were correctly separated. Thus the Commissioner was unsure; whether or not the bifurcation were right or wrong. This does not show and establish that the finding of the assessing officer was erroneous.

10. The appellant-assessee has placed on record a letter dated 12th August, 2011, which was filed before the Commissioner in response to the notice under Section 263 of the Act. In the said reply, reference was made



to several decisions of the Supreme Court as well as this Court on the scope of Section 263 and it was highlighted that the Assessing Officer had carried out due verification and scrutiny and was satisfied that the bifurcation/apportionment was justified and correct. Under Section 263, fresh adjudication by the Assessing Officer cannot be directed, unless for cogent and good reasons a clear cut and specific finding was made that the assessment made by the Assessing Officer on the said aspect on merits was erroneous and was prejudicial to the interest of the Revenue. The appellant-assessee in the aforesaid reply had also referred to their letter dated 17th August, 2009, filed before the Assessing Officer giving the basis for allocation of common expenditure. Reference was also made to the decision of the Delhi High Court in ***CIT Vs. ARJ Security Printers***, (2003) 264 ITR 276 (Delhi). Copy of the letter dated 2nd July, 2009 written by the appellant-assessee to the Assessing Officer has been placed on record. By letter dated 17th August, 2009, the appellant assessee had stated before the Assessing Officer that there were two separate and independent units, and that the common expenditure identified had not been booked directly and had been apportioned at the end of the year. Aspects whether expenses made related to sale or purchases, if so, to each unit etc. had been kept in mind in accordance with common accounting principles. Details of the apportionment of common expenses were separately enclosed.



11. It is also clear from the order passed by the Commissioner under Section 263 that the issue relating to apportionment of common expenditure was specifically gone into and examined by the Assessing Officer, who was fully satisfied with the apportionment made. Thus, it was not a case of “no” inquiry but specific and pointed enquiries by the Assessing Officer. The said finding and apportionment could have been set aside and negated only with a finding by the Commissioner, that the Assessing Officer was erroneous and wrong. The Commissioner should have examined and gone into the question of apportionment on merits. Mere statement that it was possible that the Assessing Officer was erroneous, is not sufficient and does not meet the requirement stipulated by law. On the said aspect, we would like to reproduce observations of the Delhi High Court in ***Income Tax Officer Vs. DG Housing Projects Limited***, (2012) 343 ITR 329 (Delhi) wherein reference was made to ***CIT Vs. Sunbeam Auto Limited***, (2011) 332 ITR 167, and it has been held:-

“14. The aforesaid observations have to be understood in the factual background and matrix involved in the said two cases before the Supreme Court. In the said cases, the Assessing Officer had not conducted any enquiry or examined evidence whatsoever. There was total absence of enquiry or verification. These cases have to be distinguished from other cases (i) where there is enquiry but the findings are incorrect/erroneous; and (ii) where there is failure to make proper or full verification or enquiry.

15. In the case of Commissioner of Income Tax vs. Sunbeam Auto Ltd. (2011) 332 ITR 167 (Del), Delhi



High Court was considering the aspect, when there is no proper or full verification, and it was held as under:-

“We have considered the rival submissions of the counsel on the other side and have gone through the records. The first issue that arises for our consideration is about the exercise of power by the Commissioner of Income-tax under section 263 of the Income-tax Act. As noted above, the submission of learned counsel for the Revenue was that while passing the assessment order, the Assessing Officer did not consider this aspect specifically whether the expenditure in question was revenue or capital expenditure. This argument predicates on the assessment order, which apparently does not give any reasons while allowing the entire expenditure as revenue expenditure. However, that by itself would not be indicative of the fact that the Assessing Officer had not applied his mind on the issue. There are judgments galore laying down the principle that the Assessing Officer in the assessment order is not required to give detailed reason in respect of each and every item of deduction, etc. Therefore, one has to see from the record as to whether there was application of mind before allowing the expenditure in question as revenue expenditure. Learned counsel for the assessee is right in his submission that one has to keep in mind the distinction between “lack of inquiry” and “inadequate inquiry”. If there was any inquiry, even inadequate that would not by itself give occasion to the Commissioner to pass orders under section 263 of the Act, merely because he has a different opinion in the matter. It is only in cases of “lack of inquiry” that such a course of action would be open. In *Gabriel India Ltd.* [1993] 203 ITR 108 (Bom), law on this aspect was discussed in the following manner (page 113):



“ . . . From a reading of sub-section (1) of section 263, it is clear that the power of suo motu revision can be exercised by the Commissioner only if, on examination of the records of any proceedings under this Act, he considers that any order passed therein by the Income-tax Officer is „erroneous in so far as it is prejudicial to the interests of the Revenue“ . It is not an arbitrary or unchartered power, it can be exercised only on fulfilment of the requirements laid down in sub-section (1). The consideration of the Commissioner as to whether an order is erroneous in so far as it is prejudicial to the interests of the Revenue, must be based on materials on the record of the proceedings called for by him. If there are no materials on record on the basis of which it can be said that the Commissioner acting in a reasonable manner could have come to such a conclusion, the very initiation of proceedings by him will be illegal and without jurisdiction. The Commissioner cannot initiate proceedings with a view to starting fishing and roving enquiries in matters or orders which are already concluded. Such action will be against the well-accepted policy of law that there must be a point of finality in all legal proceedings, that stale issues should not be reactivated beyond a particular stage and that lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity. (See Parashuram Pottery Works Co. Ltd. v. ITO [1977] 106 ITR 1 (SC) at page 10) . . . From the aforesaid definitions it is clear that an



order cannot be termed as erroneous unless it is not in accordance with law. If an Income-tax Officer acting in accordance with law makes a certain assessment, the same cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately. This section does not visualise a case of substitution of the judgment of the Commissioner for that of the Income-tax Officer, who passed the order unless the decision is held to be erroneous. Cases may be visualised where the Income-tax Officer while making an assessment examines the accounts, makes enquiries, applies his mind to the facts and circumstances of the case and determines the income either by accepting the accounts or by making some estimate himself. The Commissioner, on perusal of the records, may be of the opinion that the estimate made by the officer concerned was on the lower side and left to the Commissioner he would have estimated the income at a figure higher than the one determined by the Income-tax Officer. That would not vest the Commissioner with power to re-examine the accounts and determine the income himself at a higher figure. It is because the Income-tax Officer has exercised the quasi-judicial power vested in him in accordance with law and arrived at a conclusion and such a conclusion cannot be formed to be erroneous simply because the Commissioner does not feel satisfied with the conclusion . . . There must be some prima facie material on record to show that tax which was lawfully exigible has not been imposed or that by



the application of the relevant statute on an incorrect or incomplete interpretation a lesser tax than what was just has been imposed . . . We may now examine the facts of the present case in the light of the powers of the Commissioner set out above. The Income-tax Officer in this case had made enquiries in regard to the nature of the expenditure incurred by the assessee. The assessee had given detailed explanation in that regard by a letter in writing. All these are part of the record of the case. Evidently, the claim was allowed by the Income-tax Officer on being satisfied with the explanation of the assessee. Such decision of the Income-tax Officer cannot be held to be „ erroneous“ simply because in his order he did not make an elaborate discussion in that regard.”

16. Thus, in cases of wrong opinion or finding on merits, the CIT has to come to the conclusion and himself decide that the order is erroneous, by conducting necessary enquiry, if required and necessary, before the order under Section 263 is passed. In such cases, the order of the Assessing Officer will be erroneous because the order passed is not sustainable in law and the said finding must be recorded. CIT cannot remand the matter to the Assessing Officer to decide whether the findings recorded are erroneous. In cases where there is inadequate enquiry but not lack of enquiry, again the CIT must give and record a finding that the order/inquiry made is erroneous. This can happen if an enquiry and verification is conducted by the CIT and he is able to establish and show the error or mistake made by the Assessing Officer, making the order unsustainable in Law. In some cases possibly though rarely, the CIT can also show and establish that the facts on record or inferences drawn from facts on record *per se* justified and mandated further enquiry or investigation but the Assessing Officer had erroneously not undertaken the same. However, the said finding



must be clear, unambiguous and not debatable. The matter cannot be remitted for a fresh decision to the Assessing Officer to conduct further enquiries without a finding that the order is erroneous. Finding that the order is erroneous is a condition or requirement which must be satisfied for exercise of jurisdiction under Section 263 of the Act. In such matters, to remand the matter/issue to the Assessing Officer would imply and mean the CIT has not examined and decided whether or not the order is erroneous but has directed the Assessing Officer to decide the aspect/question.

17. This distinction must be kept in mind by the CIT while exercising jurisdiction under Section 263 of the Act and in the absence of the finding that the order is erroneous and prejudicial to the interest of Revenue, exercise of jurisdiction under the said section is not sustainable. In most cases of alleged “inadequate investigation”, it will be difficult to hold that the order of the Assessing Officer, who had conducted enquiries and had acted as an investigator, is erroneous, without CIT conducting verification/inquiry. The order of the Assessing Officer may be or may not be wrong. CIT cannot direct reconsideration on this ground but only when the order is erroneous. An order of remit cannot be passed by the CIT to ask the Assessing Officer to decide whether the order was erroneous. This is not permissible. An order is not erroneous, unless the CIT hold and records reasons why it is erroneous. An order will not become erroneous because on remit, the Assessing Officer may decide that the order is erroneous. Therefore CIT must after recording reasons hold that the order is erroneous. The jurisdictional precondition stipulated is that the CIT must come to the conclusion that the order is erroneous and is unsustainable in law. We may notice that the material which the CIT can rely includes not only the record as it stands at the time when the order in question was passed by the Assessing Officer but also the record as it stands at the time of examination by the CIT [see *CIT vs. Shree Manjunathesware Packing Products*, 231 ITR 53 (SC)]. Nothing bars/prohibits the CIT from collecting and relying upon new/additional material/evidence to



show and state that the order of the Assessing Officer is erroneous.

18. It is in this context that the Supreme Court in ***Malabar Industrial Co. Ltd. vs. Commissioner of Income Tax***, (2000) 243 ITR 83 (SC), had observed that the phrase „prejudicial to the interest of Revenue“ has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of Revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interest of Revenue. Thus, when the Assessing Officer had adopted one of the courses permissible and available to him, and this has resulted in loss to Revenue; or two views were possible and the Assessing Officer has taken one view with which the CIT may not agree; the said orders cannot be treated as an erroneous order prejudicial to the interest of Revenue unless the view taken by the Assessing Officer is unsustainable in law. In such matters, the CIT must give a finding that the view taken by the Assessing Officer is unsustainable in law and, therefore, the order is erroneous. He must also show that prejudice is caused to the interest of the Revenue.”

12. Income Tax Appellate Tribunal, in the impugned order dated 26th April, 2013, did record and has reproduced the relevant portions of the notice under Section 143(2) wherein details of the commission paid to related parties, etc. were mentioned. However, it did not notice the letters/ replies dated 22nd June, 2009, 2nd July, 2009; and, 17th August, 2009, filed before the Assessing Officer and has observed that the appellant-assessee was unable to furnish the details enclosed with the reply or to show that the questions in this regard were asked by the Assessing Officer. Accordingly, the decision of the Supreme Court in the case of

Malabar Industrial Company Limited Vs. Commissioner of Income Tax,



(2000) 243 ITR 83 would not help the appellant-assessee. This finding completely incorrect as this was not even the case of the Commissioner in the order passed and which was made the subject matter of challenge before the Tribunal.

13. On the question of disallowance under Section 36(1)(ii), the Tribunal has not recorded or given any finding. The arguments raised by the appellant-assessee on the said aspects have not been considered.

14. In view of the aforesaid position, we do not think that the order of the Tribunal upholding the order of Commissioner of Income Tax , passed under Section 263, can be sustained. However, as the Tribunal has not considered the factual matrix or the various documents on record and has not examined the scope of Section 36(1)(ii), we feel that it will be proper and appropriate if the Tribunal re-examines and re-hears the appeal on merits once again. Order of remand is passed.

15. The question of law is accordingly answered in favour of the appellant-assessee and against the respondent-Revenue but with an order of remand. The appeal is disposed of. No costs.

SANJIV KHANNA, J.

V. KAMESWAR RAO, J.

AUGUST 13, 2014
VKR