

(2014) 09 BOM CK 0098

Bombay High Court

Case No: Income Tax Appeal Nos. 604 & 603 of 2011 and 487 & 492 of 2012

The Commissioner of
Income Tax

APPELLANT

Vs

LIC Housing Finance
Ltd.

RESPONDENT

Date of Decision: Sept. 12, 2014

Acts Referred:

- Income Tax Act, 1961 - Section 263, 36, 36(1), 36(1)(vii), 36(1)(viii)

Citation: (2014) 272 CTR 10 : (2014) 3 ITR 458

Hon'ble Judges: S.C. Dharmadhikari, J; A.K. Menon, J

Bench: Division Bench

Advocate: Vimal Gupta, Sr. Counsel, Vipul Bajpayee, Suresh Kumar, Advocate for the Appellant; Arun Sathe, Aarti Sathe and Kalpesh Turalkar, Advocate for the Respondent

Judgement

A.K. Menon, J.

The above appeals raise the following common questions of law :

(a) Whether on the facts and in the circumstances of the case and in law the Tribunal was right in quashing the order of the Commissioner of Income Tax passed u/s. 263 of the Income Tax Act ?

(b) Whether on the facts and in the circumstances of the case and in law, the Tribunal was correct in holding that two views are possible with regard to the applicability of Section 36(1)(viii) read with Section 41(4A) even though the provisions of Section 36(1)(viii) as amended with effect from 1/4/1997 do not provide any room for interpretation other than the one adopted by the Commissioner of Income Tax in his order passed u/s. 263 of the Income Tax Act ?

2. These appeals are filed by the revenue pertaining to assessment years 2003-04 and 2004-05 respectively. The common issue that arises pertains to the provisions of

Section 36(1)(viii) of the Income Tax Act in terms of which a special reserve could be created by the Respondents out of the profits of the company. The special reserve in the present case relates to financial year 1996-97. The Respondents are in the business of housing finance and they claimed deductions in sums of Rs.10 crores and Rs.25 crores in the assessment year 2003-04 and 2004-05 respectively. The special reserve fund was created u/s 36(1)(vii) of the Act as applicable and amounts transferred to special reserve were exempted from tax at the material time. When the amounts were transferred to the special reserve section 36(1)(viii) read as under :

"(viii) in respect of any special reserve created by a financial corporation which is engaged in providing long- term finance for industrial or agricultural development in India or by a public company formed and registered in India with the main object of carrying on the business of providing long- term finance for construction or purchase of houses in India for residential purposes, an amount not exceeding forty per cent of the total income (computed before making any deduction under this clause) and carried to such reserve account.

Provided that the corporation or, as the case may be, the company) is for the time being approved by the Central Government for the purposes of this clause.

Provided further that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid-up share capital (excluding the amounts capitalised from reserves) of the corporation or, as the case may be, the company, no allowance under this clause shall be made in respect of such excess".

3. In effect deduction of an amount not exceeding forty per cent of the profits derived from the business of providing long-term finance could be carried to a special reserve, created by a financial corporation. The deduction was admissible provided the assessee is approved by the Central Government. The aggregate of the amounts carried over to the special reserve from time to time could not exceed twice the amount of paid up share capital and general reserves.

4. Subsequently, the aforesaid provision was amended by the Finance Act, 1997 with effect from 1.4.1998 whereby the words "and maintained" were added in section 36(1)(vii) after the word "created". Thus the reserve fund created was required to be maintained. If the amount so maintained was moved out of reserve fund, the same would be liable to tax in that year. The assessee's contention is that once it transferred the amount to the special reserve prior to amendment it is not prevented from using the same in any manner and in the instant case withdrawal of those funds viz Rs.10 crores and Rs.25 crores respectively would not render these amounts liable to tax. At the same time section 41 of the Act was also amended and a new sub-section (4A) was introduced in section 41 by virtue of which any amount withdrawn from this special reserve, would be subject to tax to the year in which the

said amount was withdrawn. The amendments took effect from 1st April, 1998 and would continue to apply in relation to assessment year 1998 and 1999 and subsequent years. For case of reference the relevant section 36(1)(viii) post amendment and section 41(4A) are reproduced below :

"36(1) (viii) in respect of any special reserve created and maintained by a specified entity, an amount not exceeding twenty per cent of the profits derived from eligible business computed under the head "Profits and gains of business or profession" (before making any deduction under this clause) carried to such reserve account"

"41(4A) Where a deduction has been allowed in respect of any special reserve created and maintained under clause (viii) of sub-section (1) of section 36, any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income tax as the income of the previous year in which such amount is withdrawn".

Clause 36(1)(viii) as it originally stood merely required creation of special reserve. There was no obligation to maintain the same. In order to ensure that such financial corporation maintained the reserve so created, the amendment was brought about and the words "special reserve created and maintained" were brought into to substitute the word "special reserve created".

5. According to Mr. Gupta, learned senior counsel for the Appellant, the tribunal has proceeded on misapplication of law. He submitted that the CIT was correct in holding that the assessment was erroneous and correctly set aside the assessment order dated 16.12.2005 and directed computation of the total income of the assessee after including amount of Rs.10 crores withdrawn in the assessment year 2003-04 from the special reserve which was admittedly created prior to 1.4.1996. The tribunal misapplied the law in setting aside the order of CIT and allowing the appeals of the assessee. Similarly, Mr. Gupta further submitted that the Tribunal had held that the jurisdiction u/s 263 of the Act by CIT was improper since two views were possible with regard to applicability of section 36(1)(viii) read with section 41(4A) and in such circumstances while deduction has been allowed in respect of special reserve created and maintained under clause (viii) of section 36(1) any amount subsequently withdrawn from the special reserve shall be admitted to be profit and gain of the business and accordingly chargeable to the income tax as income of the previous year in which such amount is withdrawn. Section 41(4A), we have noted was brought into effect by the Finance Act on 1.4.1998 and it is case of the respondent-assessee that this provision has no application to the amounts remitted in special reserve prior to 1.4.1998.

6. Mr. Gupta relied upon the judgment of [MALABAR INDUSTRIAL CO. LTD. Vs. COMMISSIONER OF INCOME TAX](#), wherein the Apex Court dealt with power u/s 263 and held 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 rendering the Order erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind. Mr. Gupta therefore sought to support his submission on the basis that Malabar Industrial Co. Ltd. (supra) justifies the action of CIT.

7. Mr. Sathe, learned senior counsel appearing on behalf of the assessee contended that the provisions of section 41(4A) will have no application at all since it came into effect only in 1998. The amendment to section 36(1)(viii) and obligation to maintain the special reserve fund also came into effect from 1998. According to Mr. Sathe special reserve fund has been created prior to the date when the amendment came into force. There is no restriction on withdrawal of this amount parked in a special reserve fund and withdrawal of the said amount post 1st April, 1998 will not attract the provisions of amended section 36(1)(viii) or the provisions of section 41(4A). According to Mr. Sathe after the amendment to section 36(1)(viii) the assessee is obliged to maintain the fund created after that date. Section 41(4A) also does not come into effect in the cases where monies were transferred to the fund prior to the amendment coming into the effect. The amounts were already parked in fund therefore would remain unaffected by treating such withdrawal as income by profit and gain of business for the previous year in which the said amount is withdrawn.

8. In other words, the amendment to section 36(1)(viii) and introduction of section 41(4A) takes effect prospectively from 1.4.1998 and not retrospectively so as to effect burden of withdrawal of Rs.10 crores with tax. Mr. Sathe relied upon the following judgments in support of his contentions :

- (1) [Commissioner of Income Tax Vs. Max India Ltd.,](#)
- (2) [Grasim Industries Ltd. Vs. Commissioner of Income Tax,](#)
- (3) [Commissioner of Income Tax Vs. Gabriel India Ltd.,](#)
- (4) CIT vs. I.F.C.I Ltd. 66 DIR 490
- (5) [Kerala Financial Corporation Vs. Commissioner of Income Tax,](#)
- (6) (2009) 312 ITR 122
- (7) [T.S. Balaram, Income Tax Officer, Company Circle IV, Bombay Vs. Volkart Brothers, Bombay,](#)
- (8) Mepco India Ltd. vs. CIT (2009) 319 ITR 308
- (9) [Commissioner of Income Tax Vs. Jindal Stainless Limited,](#)
- (10) [Dinosaur Steels Ltd. Vs. Joint Commissioner of Income Tax,](#)

9. He submitted that when two views are possible the department ought not to exercise the powers u/s 263 of the Income Tax Act as the view taken is not prejudicial to interest of the Revenue. According to him the phrase "prejudicial to the interests of the Revenue" u/s 263 of the Act has to be read in conjunction with the expression "erroneous" order passed by the assessing officer. Every loss of revenue as a consequence of an error of an Assessing Officer cannot be treated as prejudicial to the interests of the revenue. Similarly, the order passed by the tribunal in favour of the assessing officer is not to be considered as prejudicial to the interests of the revenue if the order was passed on the basis of an erroneous conclusion.

10. After hearing both sides, we are of the view that merely because, the tribunal adopts one of two views possible and that has resulted in loss of the Revenue it cannot be treated as erroneous order prejudicial to the interest of the Revenue unless the view taken by the tribunal is unsustainable in law. In the present case we are unable to accept the contentions of the revenue that the order is unsustainable in law. We will shortly deal with the reasons for arriving at this conclusion. However, before proceeding to do so we will briefly refer to some of the judgments relevant to the issue of two views being possible.

11. This court held in the matter of Grasim Industries Ltd. (supra) that the condition precedent to the exercise of jurisdiction u/s 263 was that the order sought to be revised must be erroneous insofar as it was prejudicial to the interests of the revenue. Where two views are inherently possible and the assessment could not be subjected to the jurisdiction u/s 263. A similar view has been taken by the another Division Bench of this Court in CIT vs. Gabriel India Ltd. (supra) this view has been consistently followed. On the issue pertaining to applicability of the amended provision of reserve funds created prior to the amendment the Delhi High Court in CIT vs. I.F.C.I. (supra) has followed the analysis of the Kerala High Court in the matter of [Kerala Financial Corporation Vs. Commissioner of Income Tax](#), . While interpreting the provisions of the amendment, the Kerala High Court held that the amendment was prospective and would be applicable only for the assessment year 1998-99 and therefore cannot be applied for the assessment years prior thereto. The said judgment has held that deduction that has been allowed in respect of amounts transferred to the special reserve u/s 36(1)(viii) of the Act prior to amendment and which amounts were subsequently withdrawn should not be subjected to tax. Going by the plain language as it stood at the relevant time, it can be seen that creation of a reserve was sufficient to entitle the assessee to claim the benefit u/s 36(1)(viii) and the assessee was not obliged to maintain the said reserve. The inclusion of words "and maintain" was not retrospective. We do not find any reason to differ from this view expressed by the Kerala High Court and which was quoted with approval by Delhi High Court in CIT vs. I.F.C.I. (supra).

12. In the present case Mr. Sathe was also able to demonstrate from the schedule forming part of the balance sheet and profit and loss account for the year ended 31st March, 2003 that the respondent - assessee had inserted a Note on Accounts being Note No. 19 which is reproduced below for case of reference :

"19. Special Reserve has been created over the years in terms of Section 36(1)(viii) of the Income Tax Act, 1961 out of the profits of the Company. Special Reserve No.I relates to the amounts transferred upto financial year 1996-97. Whereas Special Reserve No.II relates to the amounts transferred thereafter. In the current financial year Rs.10,00,00,000/- (Previous Year Rs.20,00,00,000/-) has been transferred from Special Reserve No.I to Profit and Loss account."

This note clarifies that the special reserve had been created over the years out of the profits and that first of these reserves relates to the amount which had been transferred upto financial year 1995-96. Thus, it is not as though the Assessee has surreptitiously transferred any amount nor it is the case of the revenue that transfer of such funds from the special reserve was in any manner contrary to any law. The case of the revenue is that where two views were possible, the view which is prejudicial to the revenue ought not to be taken.

13. Having considered the judgment of Malabar Industrial Co. Ltd. (supra) in our view there was no justification for invoking section 263 and setting aside the order of the assessing officer. The order of the assessing officer was upheld by the Tribunal since it held one of two possible views. Neither view could be stated to be erroneous and/or prejudicial to the interests of the revenue nor was the order passed without following principles of natural justice or without application of mind.

14. In the circumstances even after applying the test of in Malabar Industrial Co. Ltd. (supra) there appears no justification in setting aside the order of the assessing officer. For the said reasons there is no justification in assailing the order of the tribunal which correctly held that there was no obligation to maintain the fund, when the fund was created and the withdrawal of the fund from the special reserve was before the obligation to maintain the fund came into effect on 1st April, 1998. The withdrawals that have occasioned in the each of the above petitions do not fall foul of law. There are no errors apparent on the face of the record. Accordingly, we answer the question "A" and "B" in the affirmative i.e. in favour of assessee and against the revenue. The appeals are therefore dismissed. The effective date of amendment should read 1.4.1998. No order as to costs.