

# Delhi High Court rules that refund cannot be adjusted against outstanding demand without prior intimation to taxpayer

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## In brief

The Delhi High Court (HC) held that it is mandatory for the Revenue to give prior intimation to the taxpayer in writing before setting off refunds due against any outstanding demands. Further, by issuing a *post facto* intimation, the Revenue cannot seek to correct the fatal error arising from the clear violation of the mandatory requirement under section 245 of the Income-tax Act, 1961 (the Act).

## In detail

### Facts

- The taxpayer<sup>1</sup> had filed its income-tax return for assessment year (AY) 2006-07 on 31 July, 2006, declaring income from salary and income from other sources. The taxpayer had claimed exemption for long-term capital gains (LTCG) with respect to sale of agricultural land.
- The Tax Officer (TO) in the order passed under section 143(3) denied the exemption to LTCGs.
- Aggrieved by the aforesaid order, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)], which was decided partly in favour of the taxpayer.
- Against the aforesaid order, both the Revenue and the

taxpayer filed an appeal before the Income-tax Appellate Tribunal (Tribunal). During the pendency of appeal before the Tribunal, the Revenue recovered some amount from the taxpayer.

- In the interim, the taxpayer expired and the matter was pursued by his legal heir (for convenience, the legal heir is referred to as the “taxpayer” in the remaining part of this alert). The Tribunal *vide* order dated 12 December, 2014 allowed the taxpayer’s appeal and dismissed the Revenue’s appeal.
- The taxpayer filed an application on 17 December, 2014 for giving effect to the Tribunal order and issue of refund along with interest thereon. Subsequently, the taxpayer filed reminder letters on 6

April, 2015, 17 August, 2015 and 28 September, 2015 for giving effect to the Tribunal’s order and subsequently, granting refund along with interest thereon.

- While the refunds were awaited, the Revenue’s appeal against the Tribunal order was dismissed by the HC.
- On failure to receive any response from the Revenue, the taxpayer filed a Writ Petition<sup>2</sup> (first writ petition) before the HC, which was disposed off *vide* order dated 15 December, 2015. During the proceedings for this Writ Petition, the Departmental Representative informed the HC that the refund along with interest had been processed, and the same would be paid to the taxpayer within two weeks. Accordingly, the Writ

<sup>1</sup> [W. P. (C) 683 / 2016]

<sup>2</sup> W. P. (C) 10985 of 2015

Petition was disposed off with an option to the taxpayer to approach the HC if the refund was not granted.

- On 7 December, 2015, the taxpayer received a letter from State Bank of India along with a demand draft of INR 12,901,503 on account of the income-tax refund for AY 2006-07 as against his entitlement of INR 16,535,770. On following-up with the Revenue, the taxpayer was informed that the remaining sum was adjusted against the demand for a subsequent year. The taxpayer was presented with a defaced refund adjustment voucher, which revealed that a portion of the gross refund was to be adjusted against demand for AY 2008-09.
- The taxpayer had filed an appeal together with an application for stay of demand before the CIT(A) for AY 2008-09, which was pending disposal.
- Aggrieved by the Revenue's action of setting off refunds against a demand pertaining to AY 2008-09 without prior intimation, the taxpayer filed this Writ Petition.

### **Issue before the High Court**

Was the action of the Revenue in setting off the refund for AY 2006-07 against the demand for AY 2008-09 without prior intimation to the taxpayer justified under the Act?

### **Taxpayer's contentions**

- The taxpayer relied upon various Court rulings<sup>3</sup> and instruction<sup>4</sup> of Central Board of Direct Taxes (CBDT) and contended as under :

- Adjustment of demand, without prior intimation or affording an opportunity of being heard, was in gross violation of section 245 of the Act.
- The Revenue had to be satisfied that the taxpayer would not be in a position to satisfy the demand of tax and that the outstanding tax amount could not be recovered at all, before adjusting the refund against the outstanding demand.
- Further, the taxpayer stated that it had filed an appeal together with a stay application before the CIT(A) for AY 2008-09, which was pending disposal by the CIT(A).

### **Revenue's contentions**

- The Departmental Representative argued that the balance amount of INR 3,634,257 was not released to the taxpayer pending verification of the unpaid outstanding demand for subsequent year.
- The question of issuing a notice under section 245 of the Act did not arise since the Revenue had not "adjusted" any sum but merely withheld it, pending verification of the outstanding demand.
- The notice under section 245 of the Act had been issued to the taxpayer on 21 March, 2016, and *post* the taxpayer's response to the same, an order would be passed in a time-bound manner.

### **High Court's ruling**

- The HC held that as per the mandate of section 245, where a refund was found to be due

to any person in lieu of payment of the refund, it would be left to the discretion of the Revenue to set off the refund, against the amount found payable "after giving an intimation in writing to such person of the action proposed to be taken under this section". In so holding, the HC relied on the co-ordinate bench ruling in the cases of Glaxo Smith Kline Asia (P) Limited<sup>3</sup> and The Oriental Insurance Company Limited<sup>3</sup>.

- The HC observed that although the refund voucher mentioned "adjustment to be made", the refund was issued after adjusting the demand. The HC rejected the Revenue's argument that it had merely "withheld" the balance refund pending the verification of demand for the subsequent year, and had not adjusted the demand. The HC further observed that the Revenue was fully aware that the matter for the subsequent year was pending with the CIT(A) and hence, it could not be said that the said amount was pending "verification" of demand.
- The HC also noted that in the instant case, the notice under section 245 was served two months after the notice was issued by this Court in the present petition. By doing so, the Revenue could not seek to correct the fatal error arising from a clear violation of the mandatory requirement of section 245.
- Accordingly, the HC directed that the Revenue had to forthwith issue a balance refund to the taxpayer together with interest up to the date of payment without any delay, and no coercive action should be taken by the Revenue for AY 2008-09 until

<sup>3</sup> Glaxo Smith Kline Asia (P) Limited v. CIT [(2007) 290 ITR 35 (Delhi HC), Genpact India v. ACIT [(2012) 205 Taxman 51

(Delhi HC) and The Oriental Insurance Co. Ltd. v. DCIT [W. P. (C) 6172/ 2014]

<sup>4</sup> Instruction No. 1952/ 1998 dated 14 August, 1998 and Instruction No. 12/ 2013 dated 9 September, 2013

the time the CIT(A) had passed an order on the stay application along with the appeal thereon.

### ***The takeaways***

- The set-off of refund against an outstanding demand for another year is a routine procedure followed by the Revenue in India. There may be instances where the requisite intimation is not issued and opportunity of

being heard is not granted to the taxpayer before making such an adjustment.

- This decision is a welcome one, as it reinforces the need to strictly adhere to the procedure laid down under section 245 of IT Act. This will also ensure that principles of natural justice are duly followed. This decision should help taxpayers who are engaged in litigation on a similar issue.

### ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact:

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