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Revision proceedings valid despite in-depth examination of claim by tax officer

In brief

Recently, in the case of Cairn Energy India Pvt. Ltd.[1] (the assessee), the Chennai Income-tax Appellate Tribunal (the Tribunal) held that revision under section 263 of the Income-tax Act, 1961 (the Act) for examining the claim for deduction under section 80-IB(9) of the Income-tax Act, 1961 (the Act) is valid despite the fact that the assessing officer (AO) has sought explanation in the original assessment. The AO's failure to apply mind renders the order erroneous and prejudicial to the interest of the revenue department.

Facts

- The assessee is a company incorporated in New South Wales, Australia, as a subsidiary of Cairn Energy Plc. incorporated in Edinburgh, UK.
- It is engaged in exploration and production of oil and gas in India. It acquired a participating interest in various (Ravva Satellite Gas Field and Lakshmi Gas Field) oil and gas blocks.
- It submitted its return of income, declaring an income of INR 491.69 millions after claiming deduction of INR 685.57 millions under section 80-IB(9) of the Act.

[1] Cairn Energy India Pvt Ltd v.DIT [TS-921-ITAT-2012(CHNY)]

- The AO sought justification for claiming deduction under section 80-IB of the Act. The assessee submitted a letter to the AO giving details of deduction claimed.

- The claim of the assessee was duly supported by certificates from a chartered accountant. The AO completed the assessment after making certain disallowances but allowing deduction under section 80-IB(9) of the Act.

- The Director of Income-tax (DIT) issued a notice under section 263 of the Act proposing to invoke the powers vested in him, for the order of assessment considering it to be erroneous and prejudicial to the interest of the revenue department.

- The DIT mentioned in the show cause notice that the claim of the assessee for deduction under section 80-IB(9) of the Act is not computed in accordance with the provisions of section 80-IB(13) of the Act read with section 80-IA(5) of the Act.

Issue

Whether the revision under section 263 of the Act for examining the claim is valid despite the fact that the AO has sought explanation in the original assessment?

Assessee's contentions

- The AO had allowed the claim under section 80-IB after due examination. The DIT could not substitute his judgment with that of the AO and could not state that the order ought to have been written more elaborately.

- The assessee placed reliance on the Madras High Court (HC) decision in the case of Silver Cloud Estates Pvt. Ltd.[2] that if there was any proposal to revise an order of a subordinate authority, it was obligatory on the part of the revisional authority to put forward all the relevant materials and give an opportunity for rebuttal. Assessee also placed reliance on the decision of the Allahabad HC in the case of Taj Printers[3].

- The reasons given in the order passed by the DIT were at variance from what was stated in the show cause notice. The DIT's objection in the show cause notice was that the computation of deduction under section 80-IB (9) of the Act was not in accordance with the provision of the Act. It was never mentioned in the show cause notice that the assessee was not entitled for deduction under section 80-IB of the Act, as was mentioned in the final order. Hence, the order deserved to be quashed.

- No opportunity was given to provide explanations for the view taken by the DIT that the assessee was not eligible for deduction under section 80-IB(9) of the Act.

- The notice was vague as it did not state the reasons as to why and how the computation of deduction under section 80-IB(9) of the Act was not in accordance with provisions of the Act.

- The Satellite Gas unit and Lakshmi Gas Field were separate undertakings and independent units, though it formed part of the oil and gas blocks. For claiming deduction under section 80-IB of the Act, there is no such requirement under the Act or rules to maintain separate accounts from the date of inception of the undertaking.

- Carry forward and set off of earlier year losses of the Ravva block against the profits before claiming deduction under section 80-IB(9) is against the law. It

[2] Silver Cloud Estates Pvt. Ltd. *v.* State of Tamil Nadu [1996] 219 ITR 244 (Mad.)

[3] CIT *v.* Taj Printers [1989] 178 ITR 384 (All.)

placed reliance on the judgment of the Madras HC in the case of Velayudhaswamy Spinning Mills Pvt. Ltd.[4]

Revenue contentions

- The Satellite Gas Field never declared the first year of commercial production, which is essential for the purpose of claiming deduction.
- The assessee did not maintain separate accounts for the units on which it had claimed deduction under section 80-IB of the Act from the inception of such units. It had filed only consolidated profit and loss accounts and balance sheet for all the blocks, together.
- The Satellite Gas unit is a part of the Ravva block which was in operation since 1994 and was not a separate undertaking. Audited accounts for preferring a claim under section 80-IB of the Act was filed for the impugned assessment year only.
- Expenses incurred for the Satellite Gas unit, prior to year of its commercial production, were never carried forward or set-off before working out the eligible deduction under section 80-IB of the Act.
- Expenses were apportioned on a pro-rata basis which itself is an indicator that separate accounts for the units preferring claim under section 80-IB of the Act were never maintained and separate audits were never done.
- The Lakshmi Gas Field comprises various units–Amba, Gowri, Parvathy, Lakshmi and others. The assessee company claimed that the Laxmi Gas Field has commenced its commercial production only from assessment year (AY) 2003-04 onwards.
- It was stated in the financial statement for the AY 2001-02 that the discovery of gas within the CBOS 2 contract area called 'Lakshmi Gas Field' was declared commercial. It is clear that the Lakshmi Gas Field is not a separate undertaking distinct from CBOS 2 block but only forms part of the CBOS 2 contract area block.
- There was failure on the part of the AO to examine in depth the claim of the assessee. Such a failure was erroneous and prejudicial to the interests of Revenue.
- Claim of the assessee that similar deductions were given to it in earlier years was also incorrect as the assessee was not having any positive gross total income for earlier years.

Tribunal ruling

- In a proceeding under section 263 of the Act, the CIT cannot travel beyond the show cause notice and if it does so then the principles of natural justice demanded an opportunity to be given to the assessee before an order is finally framed.
- For preferring a deduction under section 80-IB of the Act, the eligible business shall comply with sub-section (5) and sub-sections (7) to (12) of section 80-IA of the Act so far as it could apply.
- Deduction under section 80-IB (9) of the Act cannot be allowed if it is not worked out not in accordance with section 80-IB (13) of the Act and subsections (7) to (12) of section 80-IA of the Act.
- Not mentioning section 80-IB(5) of the Act in the show cause notice cannot be considered as an error that would render the whole proceedings void or invalid.

[4] Velayudhaswamy Spinning Mills Pvt. Ltd. *v.* CIT [2012] 340 ITR 477 (Mad)

- Section 292B of the Act can cure a slight lacunae of the nature mentioned, since the proceedings culminating in the order under section 263 of the Act was in substance and effect in conformity with or according to the intent and purpose of the Act.

- The conclusion of the DIT that the AO had not examined whether the Satellite Gas unit under the Ravva block was a separate undertaking and whether commercial production had commenced on the dates mentioned by the assessee is correct.

- The assessee in its synopsis submitted that for the financial year 2001-02 relevant to AY 2002-03, no deduction was claimed under section 80-IB of the Act.

- Assessee had worked out the deduction and filed a computation of such deduction along with return of income for the earlier year but it preferred not to make claim as its gross total income was negative. Thereby, there was no effective claim by the assessee. In such circumstances, the AO had no occasion to consider the correct date of commencement of commercial production in respect of two units in earlier years.

- The AO should have probed the correctness of allocation of expenses and decided whether the claim was in accordance with the law. There was a failure on AO's part to form an opinion. This has resulted in such assessment being erroneous and prejudicial to the interest of the revenue department. It is to address such a situation, that section 263 has been provided in the Act.

- The finding of the DIT that the assessment was erroneous insofar as it was prejudicial to interests of the revenue department cannot be faulted.

Conclusion

The assessment completed by the AO can be re-opened under section 263 of the Act if the order passed by the AO is erroneous and pre-judicial to the interest of revenue, even though such claims were dealt by the AO during the assessment proceedings.

It would not be possible for the AO to examine the deduction claimed by assessees who have negative gross total income. Hence, the effective first year of the claim would be the year when the assessees make profit and AO should verify the claim made by the assessee for that year.

This ruling has raised the issue relating to having a re-look at formative conditions even in a later year.

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Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	**Bangalore** 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	**Bhubaneswar** IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296	**Chennai** 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006 Phone +91-44 4228 5000	**Hyderabad** #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600
Kolkata 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-33 2357 9101 / 4400 1111 Fax: (91) 033 2357 2754	**Mumbai** PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	**Gurgaon** Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	**Pune** GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, pwctrs.knowledgemanagement@in.pwc.com