

Sharing insights

News Alert
13 February 2013



Revisionary powers available to CIT invalid where AO adopts ‘either perfectly correct or a possible view’

In brief

In the case of Reliance Communications Ltd.¹ (the assessee), the Mumbai Income-tax Appellate Tribunal (the Tribunal) held that the assessment order is not erroneous and prejudicial to the interests of the Revenue where the AO took either perfectly correct or a possible view and thereby does not justify revision proceedings under section 263 of the Income-tax Act, 1961 (the Act).

Facts

- For the assessment year (AY) 2007-08, the assessment was completed under section 143(3) of the Act computing the total income at nil after allowing set-off of brought forward business loss and unabsorbed depreciation.
- The Commissioner of Income-tax (CIT) passed an order under section 263 of the Act for the AY on the following three grounds:
 - a) Issue of foreign currency convertible bonds (FCCBs)**
 - The assessee raised INR 64,850 million funds through FCCBs. This was subscribed by the lead managers, Deutsche Bank Hong Kong (DB

¹ Reliance Communications Ltd v. ACIT [TS-48-ITAT-2013(Mum)]

HK), JP Morgan Securities Ltd UK and Hong Kong and Shanghai Banking Corporation.

- As per the subscription agreement between the assessee and DB HK, the bonds would be represented by a single global certificate (GC) deposited with a common depository.
- Accordingly, the bonds were registered in the name of BT Globenet Nominees Ltd., as the nominee of DB London (common depository) and not in the name of DB HK.
- The assessee instructed DB London to hold the GC on its behalf till DB HK instructs it to effect the payment and thereafter to hold it for the subscriber, DB HK.
- The assessee received payment from DB HK and the Reserve Bank of India (RBI) was informed from time-to-time about the issue of such FCCBs. The RBI authorised the assessee to issue FCCBs under the automatic approval route.
- The CIT held that the assessing officer (AO) had failed to investigate the name, address, genuineness and creditworthiness of the actual subscribers (in this case BT Globenet) to such FCCBs in terms of section 68 of the Act.
- On a separate note, the Revenue argued that the AO failed to examine the factum of the compliance of the RBI guidelines in connection with the FCCB issue. This aspect was not discussed by the CIT while passing the order.

b) Clubbing of the interest income

- The assessee transferred a sum of INR 51,420 million to its wholly-owned subsidiary, Reliance Info Investments Ltd., (RIIL).
- RIIL invested this amount in various nationalised banks and earned interest income of INR 1579.5 million.
- The AO failed to club the interest income earned on such fixed deposits with the assessee's total income under the provisions of section 60 to 63 of the Act.
- The CIT held that where an interest-free loan is given to one person by another, it is a case of revocable transfer of asset, thus invoking the provisions of section 60 to 63 of the Act.

c) Mark-to-market losses

- The assessee showed net 'unrealised forex gain on derivatives' (after setting-off unrealised losses) amounting to INR 218.9 million and offered it to tax.
- The CIT held that the component of forex loss on derivatives suffered on hedging of derivative instruments were notional losses and contingent in nature and not eligible for deduction.
- The CIT taxed the gross gain made on forex derivatives and held that the AO has erred in setting-off such losses against the total income of the assessee.

- The assessee submitted detailed arguments for this.

- The CIT set aside the assessment order stating that the AO has failed to examine the above aspects, which made the assessment order erroneous and prejudicial to the interests of the revenue.
- The assessee challenged the revisionary proceedings before the Tribunal.

Issues before the Tribunal

- Whether the CIT is justified in invoking the revisionary proceedings under section 263 of the Act where the AO has examined all the aspects during the assessment proceeding.

Tribunal ruling

a) Revisionary proceedings under section 263 of the Act

- The revision under section 263 of the Act is valid where either the assessment order was passed without any enquiry or verification of the issues or where it is found that the AO wrongly applied the provisions of the Act to the facts².
- The jurisdiction vesting in the CIT under section 263(1) of the Act is of a special and exclusive nature³ and the Tribunal can vet only the reasons recorded by the CIT for determining as to whether the order under section 263 of the Act is sustainable or not⁴.

- The adjudicating authority cannot put forth or consider any reason other than that adopted by the CIT for testing the sustainability of the order under section 263 of the Act.
- It is the duty of the AO to examine each and every aspect of the return except inconsequential items. However, it is not necessary to incorporate all the aspects examined by the AO in the assessment order.
- The CIT cannot exercise jurisdiction under section 263 of the Act if there is material on record to indicate that the AO enquired into all the relevant aspects of the assessment.
- In cases where the AO made enquiry on all the relevant aspects of the assessment but failed to reach a logical conclusion because the AO did not appreciate the facts in right perspective or failed to correctly apply the relevant legal provisions to the facts, it is duty of the CIT to point out the mistake of the AO in such cases to invoke revisionary powers under section 263 of the Act.
- The AO made enquiry about the three aspects noted by the CIT and upon such enquiry the assessee made submissions by placing all relevant documents before the AO.
- The fact that the AO did not make any reference to these three issues in the assessment order cannot make the assessment order erroneous when these issues were properly looked into by the AO.
- The AO either took perfectly correct or a possible view and the assessment order passed cannot be held as erroneous and prejudicial to the interests of the revenue.

² Arvee International v.ACIT [2006] 101 ITD 495 (Mum)
CIT v. Nalwa Investments Ltd [2011] 338 ITR 522 (Delhi)
CIT v Bhagawan Das [2005] 142 Taxmann 1 (Alh)

³ CIT v Jagadhri Electric Supply and Industrial Co [1983] 140 ITR 490 (P&H)

⁴ CIT v Chandrika Educational Trust [1994] 207 ITR 108 (Kerala)

b) Applicability of section 68 of the Act

- An obligation is cast on the assessee to prove the identity, capacity and credit worthiness of the person from whom the money is actually received.
- As far as the assessee is concerned, the only subscriber was DB HK and it was at the discretion of DB HK to find customers to subscribe to FCCB for a part or total of such issue. The assessee had no duty to report the names and addresses of the actual subscribers in its books of account.
- The assessee had no direct contact with the actual subscribers to the FCCB who were different from DB HK. Only at the time of issuance of shares i.e. upon conversion, the actual subscribers would come into direct contact with the assessee.
- The assessee has adequately discharged the onus cast upon it in terms of section 68 of the Act by disclosing the name of the subscriber i.e. DB HK.
- The CIT is not justified in requiring the assessee to prove the identity, capacity and creditworthiness of actual subscribers which was beyond the reach of assessee.

c) Applicability of sections 60 to 63 of the Act

- Ruling of Ahmedabad Tribunal in the case of Nalinbhai M. Shah⁵ wherein it was held that the income earned by family members of the assessee by using interest free loan advanced to them by the assessee out of his funds cannot be made subject matter of addition under section 60 of the Act relied upon.

⁵ ITO v. Nalinbhai M. Shah [2000] 93 TTJ 107 (Ahmd)

- Therefore, the question whether clubbing provisions are attracted in such situations is highly debatable.
- The scope of proceedings under section 263 of the Act is restricted to revising an order which is erroneous and prejudicial to the interests of the Revenue. An order cannot be said to be erroneous when the AO followed one of the legally sustainable view out of the two views available.
- The assessment order cannot be erroneous because the CIT is inclined to follow the other legally sustainable view in preference to the one followed by the AO.
- It relied on the ruling of Malabar Industrial Co. Ltd.⁶ where it was held that where two views are possible and the AO has taken one view which CIT does not agree, revisionary provisions cannot be invoked in such situations unless the view taken by the AO is unsustainable in law. The order cannot be said to be erroneous or prejudicial to the interest of the revenue.

d) Mark-to-market loss or gain

- Relying on the ruling of Woodward Governor India Pvt. Ltd.⁷, it was held that the loss suffered by the assessee on revenue account towards foreign exchange difference as on the date of balance sheet is an item of expenditure deductible under section 37(1) of the Act.
- Both loss and gain on account of derivatives assume the same character of either being contingent or non-contingent in nature.

⁶ Malabar Industrial Co. Ltd. v. CIT [2000] 243 ITR 83 (SC)

⁷ CIT v. Woodward Governor India Pvt. Ltd. [2009] 312 ITR 254 (SC)

- The assessee in the given case had earned net gain on account of forex derivatives which was offered to tax, which is not prejudicial to the interest of the revenue.
- The CIT is not correct in taxing the gross gain of forex derivatives by ignoring the loss on account of such forex derivatives.

Conclusion

This ruling would be a good defense for cases where the CIT has invoked revisionary powers under section 263 of the Act despite the fact that the AO has applied his mind and adopted either a perfectly correct or possible view while disposing of the issues, based on the information submitted by the assessee.

The judgment also lays down various instances where the CIT can invoke revisionary powers under section 263 of the Act.

About PwC India

PwC* helps organisations and individuals create the value they're looking for. We are a network of firms in 158 countries with more than 180,000 people who are committed to delivering quality in assurance, tax and advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. Tell us what matters to you and find out more by visiting us at www.pwc.com/in.

Our offices

For private circulation only

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

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

©2013 PricewaterhouseCoopers. All rights reserved. "PwC", a registered trademark, refers to PricewaterhouseCoopers Private Limited (a limited company in India) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.