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

+ **W.P.(C) 1707/2014 & CM No.3569/2014**

Reserved on:13th January 2016
Decided on: 22nd February 2016

MUNJAL SHOWA LIMITED ..... Petitioner
Through: Mr. Ajay Vohra, Senior Advocate with Ms. Kavita Jha and Ms. Roopali Gupta, Advocates.

versus

DEPUTY COMMISSIONER OF INCOME TAX & ANR. ..... Respondents
Through: Mr. Ashok K. Manchanda, Senior Standing counsel.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE VIBHU BAKHRU

J U D G M E N T

% **22.02.2016**

Dr S. Muralidhar, J.:

1. Munjal Showa Limited ('MSL') (hereafter the Assessee) has filed this petition under Article 226 of the Constitution challenging the validity of a notice dated 11th March 2013 issued by the Deputy Commissioner of Income Tax ('DCIT'), Circle-5(1), New Delhi under Section 148 of the Income Tax Act, 1961 ('Act') proposing to reassess the income of the Assessee for the Assessment Year ('AY') 2008-09 on the ground that he had reasons to believe that the Assessee's income for the said AY had escaped assessment.

2. By the order dated 14th March 2014, while directing notice to issue in the writ petition, an interim order was passed that no final assessment order be made pursuant to the impugned notice till further orders.

Background Facts

3. The background facts are that the Assessee, a public limited company, was incorporated in 1985 as a joint venture between Showa Corporation, Japan and Hero Group, India. It is engaged, *inter alia*, in the business of manufacture and sale of shock absorbers for vehicles.

4. For the previous year relevant to AY 2008-09, the Assessee filed a return of income at a total income of Rs. 25,10,74,700. The return was picked up for scrutiny. According to the Petitioner, after making exhaustive examination and proposing several disallowances a draft assessment order was passed by the Assessing Officer ('AO') under Section 143(3) of the Act on 28th November 2011. This was a draft assessment order since one of the issues examined concerned the determination of arm's length price ('ALP') of the international transaction entered into by the Assessee with its foreign associate.

5. It is significant that during the course of the assessment, notices under Section 143(2) and 142(1) were issued by the AO on 21st June 2011 requiring the Assessee to furnish the following information:

(a) the details of the short term loans taken by the Petitioner Kotak Mahindra Bank and Nova Scotia Bank.

(b) the details of the investment made during the year.

(c) the details of the dividend income earned during the year along with a justification for making 'nil' disallowances under Section 14A of the Act.

6. On 19th September 2011, the Petitioner furnished the above details including the details of interest bearing funds borrowed during the year as well as the justification for inapplicability of Section 14A of the Act to the expenses, including interest expenses incurred, on the ground that the investment yielding exempt income was not yielded from borrowed funds.

7. On 26th September 2011 another show cause notice was issued by the AO under Section 143(2) read with Section 142(1) of the Act inter alia asking the Assessee to furnish:
(i) justification as to why disallowance in terms of Rule 8D of the Income Tax Rules, 1962 ('Rules') should not be made, and

(ii) bifurcation/details of the foreign exchange ('FE') fluctuations loss.

8. This was replied to by the Assessee on 21st October 2011. As far as the justification regarding non-applicability of Secton14A of the Act read with Rule 8D of the Rules, on 28th November 2011 the Assessee furnished details of the FE fluctuation loss along with the legal justification regarding admissibility of the said loss as an allowable deduction under Section 37(1) of the Act.

9. As mentioned earlier, on 28th November 2011 the AO passed a draft assessment order. The objections thereto filed by the Petitioner were

considered by the Dispute Resolution Panel ('DRP'). By an order dated 15th June 2012, the DRP directed the AO to pass the final assessment order by issuing certain directions. On that basis, on 6th July 2012, the AO framed the assessment of the Assessee by the final order of assessment under Section 143(3) read with Section 144C of the Act assessing the total income of the Assessee at Rs. 44,29,50,186 as against the returned income of Rs. 25,10,74,695.

10. Aggrieved by the above order, the Assessee went before the Income Tax Appellate Tribunal ('ITAT') and the said proceedings are stated to be pending.

Reassessment Proceedings

11. On 11th March 2013, the DCIT issued a notice to the Assessee under Section 148 of the Act enclosing therewith the reasons proposed for reopening of the assessment for the aforementioned AY 2008-09.

12. On 17th September 2013, the Petitioner filed its legal objections to the reopening of the assessment. On 19th February 2014, an order was passed by the DCIT dismissing the objections raised by the Petitioner to the reopening of the assessment under Section 148 of the Act. Thereafter the present writ petition was filed.

13. In the 'reasons to believe' accompanying the notice dated 11th March 2013, it was stated that a perusal of the assessment record revealed that the Assessee had claimed substantial financial charges to the tune of Rs. 2,27,24,801 as compared to the interest outgo in the previous assessment

year at Rs. 60,58,887. The increase in the interest cost was mainly on account of the short term investments made through Nova Scotia Bank and Kotak Mahindra Bank for transactions of mutual fund units. However, the cost of interest expenditure related to the investment was not shown by the Assessee as being related to the investment which was subject matter of the disallowance under Section 14A of the Act. It was further stated that although disallowance under Section 14A was made by the Assessee in terms of Rule 8D and was noted in the original assessment order, but the interest expenses directly related to the investment could not be taxed since the Assessee failed to disclose the true particulars of its income in that regard. It was concluded by the AO that "there is a direct nexus between the interest expenses paid and the short term investments made by the Assessee."

14. The 'reasons to believe' recorded under Section 148 of the Act proceeded to set out, in a tabular form, the calculation of the interest expenses related to short term capital gain. The interest to be disallowed was worked out as Rs. 49,46,301.

15. The second aspect adverted to in the reasons to believe was that a sum of Rs. 9,52,93,423 claimed by the Assessee as deduction on account of FE loss. It was noted that the above figure included a sum of Rs. 1,71,43,726 which pertained to FE derivatives claimed on mark to market ('MTM') basis. It was noted that such a loss had been claimed by the Assessee for the first time. As per the Instruction No. 3/2010 dated 23rd March 2010 issued by the Central Board of Direct Taxes ('CBDT') "the notional loss incurred in case

where no sale or settlement has actually taken place and the loss has been marked on market basis resulting in reduction of book profits, will be contingent in nature and cannot be allowed to be set off against the taxable income". It was accordingly observed that a loss of Rs. 1,71,43,726, booked on MTM basis, was not allowable.

16. The AO concluded in the 'reasons for reopening the assessment' that he had reasons to believe that a sum of Rs. 49,46,301+ Rs. 1,71,43,726 aggregating to Rs. 2,20,90,027 had escaped assessment and there was a failure on the part of the Assessee to disclose the true particulars of its income by claiming expenses which were not paid.

Counter affidavit of the Respondents

17. In the counter affidavit filed on behalf of the Respondents it is stated:

(i) the Assessee had failed to prove that there was no nexus between the interest paid and the investment made for earning the dividend of Rs. 8,46,024 as stated in Schedule 15- Other income as part of the audited accounts for AY 2008-09.

(ii) None of the investments made by the Assessee during the AY in question was for a period exceeding 23 days (i.e. less than a month), whereas a Growth Plan investment is for a minimum of 12 months. Therefore, it was evident that the Petitioner never had any intention of making long-term investment in the Growth Plan. The fact that the Assessee had earned dividend income meant that the Assessee would have made certain investment to have the same. However, the Assessee failed to make

disallowance under Section 14A of the Act for the administrative and interest expenses incurred for earning of the said dividend of Rs. 8,46,024. From a perusal of Schedule 7 of the audited accounts of the Assessee, it is seen that the Assessee had invested both in growth funds as well as in the dividend plan of Birla Mutual Funds and Reliance Mutual Funds, and had earned the aforementioned dividend income of Rs. 8,46,024. This investment in the mutual funds was not declared in the original assessment. This amounted to not disclosing the full particular and complete details during the concerned AY. The declaration of cumulative interest expenses could not be considered as submitting the complete particulars. Also no break up of interest expenses in regard to investment from borrowed funds was disclosed.

(iii) After the AO had passed the final assessment order on 6th July 2012, the CIT-II reviewed the file. A review report dated 15th January 2013 was issued to the AO. The review report highlighted the erroneous judgment made by the AO with regard to the disallowances under Section 14A of the Act by making an addition of only Rs.59 and not considering the interest expenses incurred on the borrowed funds utilised for the purpose of investment by the Assessee. Further the AO failed to disallow the notional FE loss of Rs. 1,71,43,726 incurred on derivatives based on the MTM basis.

18. It is then disclosed in the counter affidavit as under:

> "CIT-II made a noting on the order sheet of the review file to call for the action taken report from the concerned officers. In view of this direction, the ITO (hqrs.) Judicial-II issued a letter 04.03.2013 to DCIT -5(1), requesting to take corrective action and action taken report in this regard to be sent to the office of CIT-II by 07.03.2013

without fail. In pursuance of the aforesaid administrative directions of the CIT, which are binding on DCIT, the remedial action was taken u/s- 147/148 and report dated 11.03.2013 was sent of the office of CIT-II. The corrective action in view of review report of CIT-II, Delhi was to be taken u/s 263, as erroneous order which was prejudicial to the interest of Revenue was passed by the AO. In Petitioner's case, the final assessment order was passed based on order of DRP, comprising of three senior CITs. In view of this fact, the CIT-II i.e., one CIT cannot override the decision of 3 CITs u/s-263. Thus, there was no alternative with the AO to take remedial action u/s- 263. Hence, the AO was left with no option but to take remedial action u/s 147/148".

Submissions of the Petitioner

19. It was submitted by Mr. Ajay Vohra, learned Senior counsel for the Assessee, that in the course of the assessment proceedings, the relevant queries regarding both the issues were raised by the Respondents. Replies were filed by the Petitioner in response to such queries. It is only after an exhaustive verification of the information supplied that the Respondents passed the original assessment order dated 6th July 2012.

20. It was pointed out that in respect to the issue of disallowance under Section 14A of the Act, the Respondents had even computed disallowance in terms of Rule 8D of the Rules. This disallowance was in fact challenged by the Petitioner before the Dispute Resolution Panel ('DRP') which confirmed the said disallowance. There was no new tangible material in the possession of the Respondents, which could have led to the formation of reasons to believe that income had escaped assessment. In fact, the reopening of the assessment was sought to be done only on the basis of change in opinion upon review of the existing material on record. Referring to the decision in ***CIT v. Kelvinator of India Ltd. (2010) 320 ITR 561 (SC)***

and ***CIT v. Usha International Ltd (2012) 25 Taxmann.com 200 (Del) (FB)***, it was submitted that this was impermissible in law. Mr. Vohra submitted that in respect of the disallowance under Section 14A of the Act, the challenge by the Petitioner to the disallowance was still pending before the ITAT when the impugned order was passed seeking to reopen the assessment.

21. Mr. Vohra further submitted that, even assuming without admitting that the entire funds borrowed from Nova Scotia Bank and Kotak Mahindra Bank were invested in mutual funds, since the investment was made in a Growth Plan which could not have yielded any exempt income, no disallowance could have been made under Section 14A of the Act read with Rule 8D of the Rules. Even as regards the disallowance of loss arising from foreign exchange derivatives ('FED') on MTM basis, necessary disclosures were duly furnished by the Assessee in the course of the original assessment proceedings in Clause 2(a) of the notes of accounts contained in Schedule 22 of the audited financial statement. That note clearly states that the profits were reduced in the relevant previous year on account of the loss of Rs. 1.71 crores being suffered on derivatives on MTM basis. By a letter dated 28th November 2011, the queries raised by the Respondents by notice dated 26th September 2011 in this regard were replied to. There was a verification undertaken by the Respondents and it is only thereafter the losses were allowed by the AO.

22. It was pointed out by Mr. Vohra that the Petitioner had followed the mercantile system and that in terms of the decision in Supreme Court in ***CIT***

v. Woodward Governor India P. Ltd. (2009) 312 ITR 254(SC), the loss arising on account of FE fluctuation in respect of the outstanding liabilities on revenue account was allowable revenue expenditure, notwithstanding that the liability was to be discharged at a later stage. The aforesaid position equally held good for derivative contracts entered into to hedge foreign currency liabilities.

23. In terms of Accounting Standard ('AS')-30 on "Financial Instruments: Recognition and Measurement" read with AS-11 on the "Effects of change in Foreign Exchange rate" issued by the Institute of Chartered Accountants of India ('ICAI'), the loss/gain on outstanding derivative contracts are to be recognized on MTM basis. The term 'Mark to Market' is a concept under which the unmatured forward contracts are valued at market rate so as to report their actual value on the reporting date. A corresponding loss is then booked through the profit and loss account, being the difference between the purchase price and the value as on the valuation date. It was submitted that as per AS-11 read with AS-30 issued by the ICAI, the companies are required to account for MTM losses in their books despite the fact that the contract has not yet matured on the date of the balance sheet. Since the loss arising out of the outstanding derivative contracts of foreign currency, on MTM basis, was an ascertained liability at the end of the relevant year, the loss was allowable as business deduction. It was submitted that the CBDT Instruction No. 3/2010, dated 23rd March 2010 could not possibly override the existing decisions of the Supreme Court and the High Court on the same issue. A reference is made to the decision in ***CCE v. Ratan Melting & Wire Industries (2008) 220 CTR (SC) 98.*** It is further submitted that if the

CIT was of the view that the order of the AO was prejudicial to the interest of the Revenue, then it is possible to invoke the powers under Section 263 of the Act. Reliance was placed on the decisions in ***CIT v. DLF Power Ltd (2012) 17 taxmann.com 269(Del)*** *and* ***Lahmeyer Holding GMBH v. DDIT (2015) 376 ITR 70(Del).***

24. Mr. Vohra further submitted that the ignorance of the AO could not be a ground for reopening the assessment. He submitted that notes to the accounts have to be read as part of the accounts which in turn were enclosed with the returns filed and therefore it could not be said that the material and true particulars were not disclosed by the Assessee. Reliance was placed on the decision in ***CIT v. Sain Processing and Wvg. Mills (P.) Ltd (2010) 325 ITR 565 (Del.)***. It was further submitted that the reasons for reopening the order had to be found in the order itself and cannot be supplied by an affidavit filed subsequently. Reliance was placed on the decisions in ***Sheth Brothers v. JCIT (2001) 251 ITR 270 (Guj)*** and ***Vijaykumar M. Hirakhanwala HUF v. ITO (2006) 287 ITR 443 (Bom.)***.

Submissions of the Respondents

25. In response to the above submissions, it was submitted by Mr. Ashok Manchanda, learned counsel for the Revenue, that it was only after the original assessment proceedings were concluded that the AO learnt that the expenditure was not on account of interest and that the financial charges in the period relevant to AY 2008-09 had increased to Rs. 2,27,24,801 as compared to the interest outgo of RS. 60,58,887 in the earlier AY 2007-08. This increased interest cost was mainly due to making of short term

investment through funds borrowed from Nova Scotia Bank and Kotak Mahindra Bank for transactions of investment in mutual funds. According to Mr. Manchanda, this interest expenditure of Rs. 49,46,301 which is included in the total financial charges of RS. 2,27,24,801 had not been shown by the Assessee as being related to the investments either in the returns filed or even in the audited tax report. According to him, if it had been disclosed, the income expenditure of Rs. 49,46,301 would not have escaped assessment.

26. Mr. Manchanda submitted that the Petitioner had surreptitiously claimed the said sum of Rs. 49,46,301 as business expenditure while it was a direct expense related to dividend and investments income from which it was either exempt or chargeable as short term capital gains. It is stated that the Assessee deliberately suppressed the material fact with a view to evade tax. Since the interest expenditure related to the investments was not discussed during the original assessment proceedings, the question of the AO changing his opinion on the same fact did not arise.

27. As regards the FE loss of Rs. 1,71,43,726 on MTM basis, Mr. Manchanda submitted that it was only a notional loss computed on the basis of market value. It was not an actually realised loss and could not be allowed as expenditure against any income. Even otherwise, the loss of any speculative nature was not allowable for set off against any profits of non-speculative nature. The loss of Rs. 1,71,43,726 to the Assessee had resulted from derivative contracts and trading activities which were speculative. It was claimed on notional MTM basis. The disclosure made in the audited report was ambiguous and could not be understood clearly. Therefore, the

said amount had to be added back to the return. In terms of Circular No. 3 of 2010, the Assessee was duty bound to declare the inadmissible loss in the return filed by it. It did not do so. Even the tax audit report declared the expenditure in this account as nil. Note No. 2(a) of Schedule 22 of the Final Accounts contained an admission by the auditor of the deviation from the previous year's policy. However, in the tax audit report, a false statement was made that there was no change in the accounting method.

28. Mr. Manchanda submitted that any disclosure made in the financial accounts or any other document during the course of the assessment proceedings was not disclosure unless "it is appropriately mentioned at the appropriate place in the return of income". Thus the Assessee had deliberately concealed and furnished inadequate particulars of income with a view to evade taxes.

Discussion and Reasons

29. The two questions that the Court proposes to examine is whether the Assessee had made complete disclosure during the assessment proceedings and whether there was any new tangible material available with the respondents for forming reason to believe that income had escaped assessment.

30. In the counter affidavit filed by the Respondents, reliance has been placed on Instruction No. 15 dated 4th November 2008, in terms of which the CIT had the administrative power to review the file and the assessment order. The CIT-II made a noting on the order sheet of the review file to call for an action taken report from the concerned officer. This was followed by

a direction being issued by the ITO (hqrs.) Judicial-II on 4th March 2013 to DCIT 5(1), asking that corrective action be taken and an action taken report be sent to the office of the CIT-II by 7th March 2013 without fail. It is admitted in the counter affidavit that pursuant to the above administrative direction of the CIT "which are binding on DCIT, the remedial action was taken u/s 147/148 and report dated 11th March 2013 was sent to the office of CIT-II".

31. The CIT did have power under Section 263 of the Act, since the final assessment order was passed based on the order of DRP, comprising of three senior CITs, the "CIT-II i.e., one CIT cannot override the decision of 3 CITs". It is further added that "the AO was left with no option but to take remedial action under Section 147/148".

32. It is obvious from the above admission by the Respondents in the counter affidavit that the AO did not apply his mind independently and went by the order of the CIT. It is a settled law that a quasi-judicial authority cannot afford to act on the direction and in the present case on the direction of a superior officer. In ***Anirudhsinhji Jadega v. State of Gujarat (1995) 5 SCC 302,*** it was reiterated by the Supreme Court that once a discretion is vested with a certain authority, he alone should exercise that discretion vested under the statute and if he acts in accordance with "the direction or any compliance with some higher authorities instruction" it would be a case of failure to exercise discretion altogether. In ***Commissioner of Income Tax v. Greenworld Corporation (2009) 314 ITR 81 (SC)*** the AO issued an order under Section 148 of the Act on the dictates of the CIT. The Supreme Court held that without going into the question of the *bona fides* of the authorities

under the Act, "the order of assessment passed by the Assessing Officer on the dictates of the higher authority, being wholly without jurisdiction, was a nullity".

33. In ***CIT v. SPL's Siddhartha Ltd. [2012] 345 ITR 223 (Del),*** it was observed as under:

> "7. Section 116 of the Act also defines the Income Tax Authorities as different and distinct Authorities. Such different and distinct authorities have to exercise their powers in accordance with law as per the powers given to them in specified circumstances. If powers conferred on a particular authority are arrogated by other authority without mandate of law, it will create chaos in the administration of law and hierarchy of administration will mean nothing. Satisfaction of one authority cannot be substituted by the satisfaction of the other authority. It is trite that when a statute requires, a thing to be done in a certain manner, it shall be done in that manner alone and the Court would not expect its being done in some other manner.
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> ....
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> 8. Thus, if authority is given expressly by affirmative words upon a defined condition, the expression of that condition excludes the doing of the Act authorised under other circumstances than those as defined. It is also established principle of law that if a particular authority has been designated to record his/her satisfaction on any particular issue, then it is that authority alone who should apply his/her independent mind to record his/her satisfaction and further mandatory condition is that the satisfaction recorded should be "independent" and not "borrowed" or "dictated" satisfaction. Law in this regard is now sell-settled. In Sheo *Narain Jaiswal & Ors. Vs. ITO, 176 ITR 35 (Pat.)*, it was held:
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>> 'Where the Assessing Officer does not himself exercise his jurisdiction under Section 147 but merely acts at the behest of any superior authority, it must be held that assumption of jurisdiction was bad for non- satisfaction of the condition precedent.'"

34. Nothing prevented the CIT from exercising powers under Section 263 of the Act if it was felt that the order of the AO is prejudicial to the interest of the Revenue. With that remedy not being availed of by the Revenue, the reopening of the assessment on the basis of the same material would amount to a change of opinion. What was also overlooked was the fact of the pendency of the Assessee's appeal before the ITAT on one of the issues that led to reopening of the assessment viz., the expenditure incurred for earning of exempt income under Section 14A.

35. At this juncture it may be useful to recapitulate the law in relation to reopening of assessments under Sections 147/148 of the Act. A Full Bench of this Court in ***CIT v. Kelvinator of India Ltd. [2002] 256 ITR 1(Del)*** held that an order purportedly passed without application of mind could not itself confer jurisdiction upon the AO to reopen the proceeding "without anything further" as that would amount to "giving a premium to an authority exercising quasi-judicial function to take benefit of its own wrong". This was upheld by the Supreme Court in ***CIT v. Kelvinator of India Ltd. (2010) 320 ITR 561(SC)***. The Supreme Court examined the amendment to the proviso to Section 147 (1) of the Act with effect from 1st April 1989 and observed that the power to reopen assessments was much wider. It went on to observed:

> "However, one needs to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, Section 147 would give arbitrary powers to the Assessing Officer to re-open assessments on the basis of "mere change of opinion", which cannot be per se reason to re-open. We must also keep in mind the conceptual difference between power to review and power to re-assess. The Assessing Officer has no power to review; he has the power to re-

> assess. But re-assessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the garb of re-opening the assessment, review would take place. One must treat the concept of "change of opinion" as an in-built test to check abuse of power by the Assessing Officer. Hence, after 1st April, 1989, Assessing Officer has power to re-open, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief."

36. In ***CIT v. Usha International Ltd [2012] 348 ITR 485(Del)*** a Full Bench of this Court observed that there could be instances where an AO may not have raise a query during the original assessment proceedings but may have examined the subject matter because the aspect or question may have been too apparent and obvious. In ***Swarovski India Pvt. Ltd. v. Deputy Commissioner of Income Tax 368 ITR 601 (Del),*** it was held that the escapement of income by itself is not sufficient for reopening the assessment in a case covered by the first proviso to Section 147 of the said Act and unless and until there was failure on the part of the assessee to disclose fully and truly all the material facts necessary for assessment, the power to reopen the assessment should not be invoked. It was insisted that the reasons for reopening of the assessment should specifically indicate which material fact was not disclosed by the Assessee in the course of the original assessment under Section 143(3) of the Act failing which there should not be any reopening of the assessment.

37. In ***Prabhu Dayal Rangwala v. Commissioner of Income-Tax 373 ITR 596 (Del)*** a Division Bench of this Court after reviewing the case law till then held:

> "18. In view of the dictum of the Supreme Court in the case of *Kelvinator of India Ltd. (supra*), the Full Bench of this court in *Kelvinator of India Ltd. (supra*) and *Usha International (supra*), the present case would fall in the category of "change of opinion" as the "reasons to believe" proceed on the premise that the opinion formed in the original assessment orders was wrong or erroneous. A wrong or erroneous opinion is not a good ground for reopening. This would be contrary to the jurisdictional requirements and the mandatory pre-conditions which should be satisfied. The said aspect has been highlighted in the aforesaid ratio by the Supreme Court and this court. Erroneous decisions can be corrected by resort to exercise of power under section 263 of the Act, which is the appropriate remedy. The said power can be exercised if the order passed by the Assessing Officer was erroneous and prejudicial to the interests of the Revenue. The error and mistake made by the Assessing Officer/Revenue in the present case is that it did not resort to and exercise the power under section 263 of the Act but erringly selected to exercise the power of reopening under section 147 of the Act. Exercise of the said power under section 147 of the Act is faulty and flawed, as jurisdictional preconditions are not satisfied."

38. Turning to the case on hand, the Court finds that in the original assessment proceedings there was complete disclosure made by the Assessee of the relevant particulars. The Revenue has been unable to counter the assertion made by the Petitioner that the investment was in mutual funds and made under the growth plan scheme that did not yield any exempt income. The income accrued by appreciation in the net value of the units held. Where the investors redeems such units before the expiry of twelve months from the date of their purchase/acquisition, then capital gains are chargeable in the hands of the investor at the maximum marginal rate prescribed under Section 111A of the Act. The Assessee made a disclosure in Schedule 15 of the profit and loss ('P&L') account, under the head "Other Income" of the

dividend earned during the relevant previous year. The financial expenses incurred by the Petitioner were reported in Schedule 20 to the P&L account. Of the total financial expenses of Rs. 2,27,24,801, the interest charges paid to the bank were Rs. 65,09,921, the interest paid to the others was in the sum of Rs. 1,51,28,845 and the bank charges amount was Rs. 10,86,035. Specific queries were raised by the AO during the course of the original assessment proceedings as regards the interest expenses. The AO rejected the contention of the Petitioner regarding low interest expense having been incurred and made a disallowance of Rs.59 which was questioned by the Assessee before the DRP unsuccessfully.

39. Apart from stating that on review, the CIT found that there should have been a greater figure of disallowance, the Respondent did not point out what tangible materials had come to their possession in order to form reasons to believe that the income had escaped assessment on the above ground.

40. The Court's attention was drawn to Schedule 7 of the audited annual accounts wherein the investments were reported. It shows that in the beginning of the year, the Assessee's investment was Rs.9664 being 961 units of Birla Sunlight Mutual Funds. They were sold during the relevant AY and therefore the balance at the end of the year was nil. The same Schedule 7 gives details of the mutual funds and number of units purchased and sold during the year. It is, therefore, not possible to accept the plea of the Revenue that the full particulars in that regard were not disclosed by the Assessee in the original assessment proceedings.

41. It was sought to be contended by Mr. Manchanda that if the investment was in growth funds and not in securities that might yield dividend, the sale of such units of growth funds would in any event attract capital gains exigible to tax. This is not one of the reasons for which the assessment is sought to be reopened. It is rightly pointed out by the counsel for the Petitioner that the reasons for reopening the assessment have to be confined to those set out in the impugned order. It cannot be improved upon by filing subsequent affidavits. The assumption of jurisdiction cannot said to be justified by supplying reasons extraneous to the recorded reasons. IN this cont4ext, the decision of this Court in ***Northern Exim (P) Ltd. v. DCIT [2013] 357 ITR 586 (Del)*** is instructive. Para 14 of the said decision reads as under:

> "14. The learned Standing Counsel for the Income Tax Department drew our attention to the entry made on 22.01.2001 in the proceedings sheet recorded in the course of the re-assessment proceedings. We have already seen that the said entry records that the authorised representative of the petitioner was asked to show cause why the difference in the amount of profit before tax and the amount declared under the VDIS cannot be treated as its income for the assessment year 1997-98 as no return of income had been filed. The entry made in the proceeding sheet is perhaps more elaborate and informative than the reasons recorded under Section 148(2) in the sense that it also states one more reason for initiating re- assessment proceedings, namely, that there is a difference between the profit before tax (Rs.42,79,340/-) and the amount declared in the VDIS (Rs.7,23,490/). The reasons recorded however are not so explicit and do not refer to this fact. We are to be guided only by the reasons recorded for re-assessment and not by the reasons or explanation given by the Assessing Officer at a later stage in respect of the notice of re-assessment.
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> ....

> The ratio laid down in all these cases is that, having regard to the entire scheme and purpose of the Act, the validity of the assumption of jurisdiction under Section 147 can be tested only by reference to the reasons recorded under Section 148(2) of the Act and the Assessing Officer is not authorised to refer to any other reason even if it can be otherwise inferred and/ or gathered from the records. He is confined to the recorded reasons to support the assumption of jurisdiction. He cannot record only some of the reasons and keep the others up his sleeves to be disclosed before the Court if his action is ever challenged in a Court of law."

42. Even as regards the loss on account of FE fluctuation, there appears to be a complete disclosure of all the relevant facts by the Assessee during the original assessment proceedings. It must be recalled that the return was picked up for scrutiny under Section 143(3) and in the balance sheet accounts (together with notes) rendered by the Assessee, there was sufficient disclosure on this aspect. Schedule 22 to the notes of accounts had a separate disclosure under the heading as under:

> "2. Statement of significant accounting policies
> a) Basis of preparation
> The financial statements have been prepared to comply in all material respects with the Notified accounting standard by Companies Accounting Standards Rules, 2006 and the relevant provisions of the Companies Act, 1956. The financial statements have been prepared under the historical cost convention on an accrual basis. The accounting policies have been consistently applied by the Company and except for the changes in accounting policy discussed more fully below, are consistent with those used in the previous year.
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> Changes in Accounting Policies
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> Accounting for Derivatives
> As per the ICAI Announcement, accounting for derivative contracts, other than those covered under AS-11, are marked to market on a portfolio basis, and the net loss after considering the offsetting effect

on the underlying hedge item is charged to the income statement. Net gains are ignored. In the previous year, no gains/losses were recognised. Had the previous year policy been followed the profit after tax would have been higher by Rs. 17,143,276 and current liabilities would have been lower by Rs. 17,143,276.

....

j) Foreign currency transactions

....

(iii) Exchange differences

Exchange differences arising on the settlement of monetary items or on reporting company's monetary items at rates different from those at which they were initially recorded during the year, or reported in previous financial statements, are recognised as income or as expenses in the year in which they arise. Exchange differences arising in respect of fixed assets acquired from outside India before accounting period commencing on or after December 7, 2006 are capitalized as a part of fixed asset.

(iv) Forward exchange contracts not intended for trading or speculation purposes The premium or discount arising at the inception of forward exchange contracts is amortised as expense or income over the life of the contract. Exchange differences on such contracts are recognised in the statement of profit and loss in the year in which the exchange rates change. Any profit or loss arising on cancellation or renewal of forward exchange contract is recognised as income or as expense for the year.

(v) Forward Exchange Contracts for trading or speculation purposes A gain or loss on such forward exchange contracts is computed by multiplying the foreign currency amount of the forward exchange contract by the difference between the forward rate available at the reporting date for the remaining maturity of the contract and the contracted forward rate (or the forward rate last used to measure a gain or loss on that contract

> for an earlier year). The gain or loss so computed is recognised in the statement of profit and loss for the period. The premium or discount on the forward exchange contract is not recognised separately."

43. The submission of Mr. Manchanda that relevant and material facts have to be specifically discussed in the returns of income of the tax audit report appears to overlook the fact that the Assessee cannot be expected to guide the AO on how he should scrutinize the accounts. In the letter dated 28th November 2011 of the Assessee in reply to the query of the AO in the original assessment proceedings, there was a whole note on exchange fluctuation enclosed in the form of Annexure-B. Despite this it cannot be said that the AO was ignorant of what the Assessee was doing in respect of foreign exchange loss while accounting for derivatives contracts. The change in the method of accounting and the consequential change in the loss figure have been adequately explained by the Assessee. Under Note J in the "Statement of significant accounting policy" in Schedule 22 to the audited annual accounts, the Assessee had made a distinction between foreign exchange contracts not intended for trading and speculative purposes and those for trading and speculative purposes. It is, therefore not possible to accept the plea of the Revenue that there was any deliberate failure on the part of the Assessee to make full and true disclosure of the change in the accounting policy that led to computation of loss as a result of fluctuation in foreign exchange derivatives.

44. This has to be also appreciated in the context of the Assessee following the mercantile system of accounting and Section 145 of the Act. The income

of the Assessee is to be computed consistent with the regular method of accounting followed by the Assessee. The Assessee has been following AS-11 and AS-30 issued by the ICAI, in terms of which the loss/gains on outstanding derivatives contracts are to be recognized on mark to market basis. The Assessee is right in contending that CBDT Instruction No. 3 of 2010 cannot possibly override the existing decisions of the Supreme Court/ High Court on similar issues. The legal position in this regard has been explained in ***Ratan Melting*** *(supra)* and has been reiterated in ***CIT v. Nagesh Knitwears (P.) Ltd. [2012] 345 ITR 135 (Delhi)*** and ***CIT v. Indian Oil Co. Ltd., (2012) 254 CTR 113 (Bom)***.

45. As pointed out by this Court in ***Lahmeyer Holding GMBH v. Deputy Director of Income Tax*** (*supra*), a distinction has been made as to the power to review and the power to re-assess. In the garb of reopening the assessment, the AO cannot be permitted to review the original assessment. That is in the domain of the CIT under Section 263 of the Act, subject of course, to compliance with the mandatory requirements of that provision. In the present case, apart from the fact that the CIT did not exercise such power, it is plain from the admission of the Revenue in the counter affidavit that the AO was acting on the direction of the CIT in terms of the instructions of the CBDT.

Conclusion

46. For the aforementioned reasons, the notice dated 11th March 2013 issued by the Respondent under Section 148 of the Act and the order dated 19th February 2014, rejecting the Petitioner's objections are hereby quashed.

47. The writ petition is allowed in the above terms but in the circumstances with no order as to costs.

S. MURALIDHAR, J

VIBHU BAKHRU, J

FEBRUARY 22, 2016
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