IN THE INCOME TAX APPELLATE TRIBUNAL, SURAT BENCH, SURAT
BEFORE SHRI PAWAN SINGH, JM & DR. A. L. SAINI, AM

आयकर अपील सं./ITA No.343/SRT/2022

निर्धारण वर्ष/Assessment Year: (2017-18)

(Physical Hearing)

Sachin Notified Area, Plot No.5719, Unnati Building, Sachin GIDC, Sachin, Surat-394230.	**Vs.**	The PCIT, Surat-1
(Appellant)		**(Respondent)**
स्थायीलेखासं./जीआइआरसं./PAN/GIR No.: **AAALS0146H**		

Appellant by	Shri P. M. Jagasheth, CA
Respondent by	Shri Ravinder Sindhu, CIT(DR)
Date of Hearing	31/05/2023
Date of Pronouncement	26/06/2023

आदेश / O R D E R

PER DR. A. L. SAINI, AM:

By way of this appeal, the assessee has challenged the correctness of the order dated 28.02.2022 passed by the Learned Principal Commissioner of Income-Tax (in short "Ld. PCIT"), under section 263 of the Income-Tax Act, 1961 (hereinafter referred to as 'the Act'), for the assessment year 2017-18. Grievances raised by the assessee, which being interconnected, will be taken up together, are as follows:

> *"1. On the facts and in the circumstances of the case as well as law on the subject, the learned Pr. Commissioner of the Income Tax has grievously erred in initiating the proceedings u/s.263 of the Act, 1961.*
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> *2. On the facts and in the circumstances of the case as well as law on the subject, the learned Pr. Commissioner of the Income Tax has grievously erred in assuming jurisdiction u/s.263 of the Act, 1961.*
>
> *3. On the facts and in the circumstances of the case as well as law on the subject, the learned Pr. Commissioner of the Income Tax has erred in violating the principles of natural justice by not the mentioning the grounds for initiating action u/s.263 of Income Tax Act, 1961 in the show cause notice issued. As*

such the order passed u/s.263 is void ab-initio. The action of the Ld. CIT was wholly unreasonable, uncalled for the bad in law.

4. On the facts and in the circumstances of the case as well as law on the subject, that the order of u/s.263 is merely 'change in opinion'. The action of the Ld. Pr. CIT was wholly unreasonable, uncalled for and bad in law.

5. On the facts and in the circumstances of the case as well as law on the subject, the learned Pr. Commissioner of Income Tax has grievously erred in assuming that the assessing officer had not verified the amount of Rs.4,21,54,142/- towards interest on FD and shown in Balance Sheet as per capital under the head of Reserve and Surplus and not made proper inquiry on finalized the order of assessment u/s. 143(3) of the I.T. Act.

6. On the facts and in the circumstances of the case as well as law on the subject, the learned Pr. Commissioner of Income Tax has grievously erred in assuming that the order was passed without making inquiries or verification into the issue of income earned from interest of FDs and passed the assessment or der without application of his mind.

7. On the facts and in the circumstances of the case as well as law on the subject, the learned Commissioner of Income Tax has grievously erred in setting aside the assessment order framed u/s. 143(3) of the I.T. Act without pointing out as to how the order is erroneous and prejudicial to interest of revenue.

8. It is therefore prayed that the above proposed proceedings may please be revoked as learned members of the tribunal may deem it proper.

9. Appellant craves liberty to add, alter or delete any ground(s) either before or in the course of the hearing of the appeal."

2. At the outset, we note that appeal filed by the assessee for assessment year 2017-18, is barred by limitation by two hundred eight (208) days. The assessee has moved a petition for condonation of delay requesting the Bench to condone the delay. We have heard both the parties on this preliminary issue and gone through the contents of the petition for condonation of delay. We note that order passed by the Ld. PCIT was uploaded online portal and it was not sent on the e-mail id, provided by the assessee. The directors of the Sachin Notified Area are changing frequently and they changed their email-id also. The e-mail-id provided to the department, was not opened by the Directors of assessee, therefore assessee was not aware whether Ld. PCIT had passed the order under section 263 or not. The Directors of the assessee- company came to

know only when the Revenue authorities raised the demand notice.The Ld. Counsel also submitted that Sachin Notified Area is a municipality area, the deemed municipality and kind of Government authority and the directors of the Sachin Notified Area are changing frequently, therefore no any director took the responsibility to file the appeal on time and hence delay has occurred. Therefore, ld Counsel prays the Bench that delay should be condoned. On the other hand, Learned Departmental Representative (Ld. DR) for the Revenue submitted that assesse has not explained the sufficient reasons to condone the delay, hence delay should not be condoned.

3. We note that the power to condone the delay is discretionary and the discretion must be judicially exercised. In considering the condonation petition, it is to be remembered that statutes conferring a right of appeal must be construed in furtherance of justice and the provision limiting the time for bringing an appeal must be liberally interpreted, so that the party pursuing such remedy allowed to him by the law is not non-suited on mere technicalities. We that the reasons given in the affidavit for condonation of delay were convincing and these reasons would constitute reasonable and sufficient cause for the delay in filing this appeal. After having gone through the affidavit as well the delay condonation application, we are of the considered opinion that in the interest of justice, the delay deserves to be condoned. We, accordingly, condone the delay and admit the appeal for hearing.

4. Succinctly, the factual panorama of the case is that assessee before us is deemed Municipality working in the name and style as 'Sachin Notified Area'. The assessee had filed its return of income for assessment year (A.Y.) 2017-18 on 24/03/2018, declaring total income NIL, after claiming deduction of Rs.13,08,46,528 u/s 10(20) of Income Tax Act. The

assessee`s case was selected for Complete Scrutiny under CASS and scrutiny assessment u/s 143(3) of the Income Tax Act. was completed on 21.12.2019, determining total income at Rs.13,08,46,530/- after disallowing deduction of Rs.13,08,46,528/- claimed by the assessee u/s 10(20) of Income Tax Act. The Assessing Officer had disallowed the deduction claimed by the assessee, stating that the assessee was not covered by the definition of Local Authority as contained in Explanation to Section 10(20) of the Income Tax Act.

5. Later, Learned Principal Commissioner of Income-Tax (in short "Ld PCIT") had exercised his jurisdiction under section 263 of the Income-Tax Act, 1961. The ld PCIT, on perusal of assessment records, noticed that the assessee had received an amount of Rs.4,21,54,142/- towards interest on FD. Interest on FD of Rs.4,21,54,142/- was not routed through Profit & Loss account and the same was directly shown in the Balance Sheet as Capital Fund, under the head Reserve and Surplus. As per ld PCIT, the income from interest on FD was required to be added to the total income of the assessee under the head income from other source. The ld PCIT noted that in this context, no inquiry was made by the Assessing Officer during the assessment proceedings. Therefore, ld PCIT observed that Assessing Officer has passed the order u/s 143(3) of the Act dated 21.12.2019 without making inquiries which should have been made and without application of mind. Therefore, ld PCIT issued a notice u/s 263 of the I.T. Act, 1961 bearing DIN No. ITBA/REV/F/REV1/2021-22/1039661288(1), dated 11.02.2022 and duly-served on the assessee. A complete detail of the facts, on account of which, the remedial action u/s 263 of the Act, proposed, was discussed in the aforesaid show-cause notice.

6. In response to the show-cause notice issued dated 11.02.2022, the assessee submitted its reply electronically before the ld PCIT. The assessee has stated in his reply that Interest on FDR amounting of Rs.4,21,54,142/- was directly shown in the Balance Sheet as capital Fund under the head Reserve and Surplus instead of Profit and Loss Account. The reason was that the income of the Notified area is exempted u/s 10(20), being as Local Authority formed under GIDC Act, 1962. Since the day of inception, the assessee is availing exemption from applicable taxes. Hence there is no loss of revenue. The assessee further argued that an appeal has already been filed against the assessment order passed by the AO before the CIT(A), therefore, assessment order has merged with the order of ld CIT(A), hence ld PCIT should not have exercised his power under section 263 of the Act, to revise such assessment order, which has been merged with the order of Ld CIT(A).

7. After considering the reply of the assessee, the ld PCIT observed that in the assessee`s case, the AO passed assessment order by not allowing exemption of Rs.13,08,46,530/- claimed u/s 10(20) of the Act stating that the assessee was not covered by the definition of Local Authority, as contained in Explanation to Section 10(20) of I.T. Act. The assessee shown such amount of Rs.13,08,46,530/-, as Net profit as per Profit and Loss account. During the year under consideration, the assesses has also earned income of Rs.4,21,54,142/- from Interest on FDs. The said income was neither credited to the Profit & Loss account nor included in computation of income filed during the assessment proceedings. Rather the income of Rs.4,21,54,142/- is directly shown in Balance-sheet as Capital Funds under the head Reserve and Surplus. Therefore, the assessee has not applied proper accounting method as every income earned by an entity should be firstly credited to Profit &Loss account of

such entity or should be included in computation of income, then exemption should be claimed, if any. During the assessment proceeding, the AO has disallowed the exemption claimed by the assessee in respect of business income shown in Profit &Loss Account. However, in respect of income earned from interest on FDs neither any inquiries were made by assessing officer nor any addition was made on account of interest received on FDs. When the AO already established that the assessee is not entitled for exemption u/s 10(20) of the Act, hence, all incomes on which the assessee has sought exemption should be disallowed and added back to total income of the assessee. Further, appellate proceeding and revision proceeding u/s 263 are distinct, and cannot be related to each other. In appellate proceeding, the assessee requested to grant relief in respect to matter already discussed in the Assessment order and addition made. Whereas in the revision process, that issue is discussed, which was left out for verification during the assessment proceeding. Therefore, ld PCIT held that AO has not inquired into the issue of income earned from interest on FDs and passed the assessment order without application of his mind. Thus, the assessment order dated 21.12.2019 is erroneous in so far as it is prejudicial to the interest of Revenue. Therefore, ld PCIT set aside the order of the AO with a direction to the Assessing Officer to pass fresh assessment order after taking into consideration the issues as may have been already considered together with the issue discussed herein above also.

8. Aggrieved by the order of ld PCIT, the assessee is in appeal before us.

9. Shri P. M. Jagasheth, Learned Counsel for the assessee, begins by pointing out that assessee is a deemed municipality, as per Gujarat Municipality Act and it is working in Sachin Notified Area and its income

is exempt under section 10(20) of the Income Tax Act. The ld Counsel submitted that in past assessment, the assessing officer allowed exemption under section 10(20) of the Income Tax Act. The ld Counsel stated that there is a similar organization in Surat, called as "M/s Hazira Notified Area", which is a semi-government body, and its assessment was carried out under section 143(3) of the Act, wherein the assessing officer accepted exemption u/s 10(20) of the Act. The Copy of assessment order of "M/s Hazira Notified Area" is placed before the Bench, and ld Counsel contended that assessee under consideration, "Sachin Notified Area" is having the same objectives and activities therefore its entire income is exempted under section 10(20) of the Act.

10. The Ld. Counsel for the assessee further submitted that Assessing Officer has disallowed the exemption u/s 10(20) claimed by the assessee and therefore made addition to the tune of Rs.13,08,46,528/-, against this disallowance, the assessee is in appeal before the Ld. CIT(A). Therefore, assessment order has merged with the order Ld. CIT(A) and therefore the said assessment order should not be revised by the Ld. PCIT under section 263 of the Act. The ld Counsel also stated that the direction given by ld PCIT (vide para 9 of his order) to the assessing officer to examine the entire issues (which were already verified by the AO), is bad in law.

11. On merit, Ld. Counsel also submitted that assessee is a deemed municipality and the Gujarat Municipality Act, is applicable to the assessee under consideration. The Ld. PCIT has exercised his jurisdiction mainly on the issue that assesse had received an amount of Rs.4,21,54,142/- towards interest on fixed deposit, which was not routed through profit and loss account and the same was directly shown in the balance sheet, as a capital fund in the head 'reserves and surplus'. The Ld. PCIT was of the view that income from interest on fixed deposit was

required to be added to the total income of the assessee under the head 'income from other sources', and in this context, no enquiry was made by the Assessing Officer, during the assessment proceedings, therefore Ld. PCIT has exercised his jurisdiction to revise the order of the Assessing Officer. The Ld. Counsel stated that assessee is governed by the provisions of section 10(20) of the Act, wherein its entire income is exempted from tax. Hence, it does not matter, whether the income has been routed through profit and loss account or directly taken to the 'reserve and surplus'. Since the income was received as an interest on fixed deposit and such income is exempted from tax u/s 10(20) of the Act, therefore such interest income was not required to show in the profit and loss account. Had such interest income been shown in the profit and loss account by the assessee, then in that situation also, whatever be the income, the same would have been exempted from tax, hence there is no loss of revenue. That is, order of the assessing officer may be erroneous but not prejudicial to the interest of revenue. This way, ld Counsel prays the Bench that order passed by the ld PCIT may be quashed.

12. On the other hand, Ld. DR for the Revenue submitted that Assessing Officer has examined the eligibility of the assessee to claim the deduction under section 10(20) of the Act and the assessing officer has observed that assessee has not fulfilled the conditions to claim deduction under section 10(20) of the Act and therefore, assessing officer has rightly denied the exemption u/s 10(20) of the Act, which is subject matter of appeal before ld CIT(A), and this issue has not been revised by ld PCIT under section 263 of the Act, as this issue has merged with the order of ld CIT(A).

13. The ld DR for the Revenue further argued that interest on fixed deposit of Rs.4,21,54,142/- is assessable under the head 'income from

other sources', and such interest income has been earned by the assessee, by way of making fixed deposit, from the surplus and unutilized contribution received from its members. Therefore, as per ld DR, the contribution received from members is exempted from tax under section 10(20) of the Act, and not the interest on fixed deposit which was earned by the assessee by parking the exempted contribution in the bank by way of fixed deposit. Hence, ld DR contended that this issue is not the subject matter of Commissioner of Income Tax (Appeal), therefore, the same is not merged with the order of Commissioner of Income Tax (Appeal). The ld DR further stated that in order to avoid the payment of taxes, the interest on fixed deposit of Rs.4,21,54,142/- has been taken directly to the balance sheet and it was not routed through profit and loss account, and such interest income has not been shown under the head 'income from other sources, and the assessee has not paid the taxes thereon, therefore to that extent, the order passed by the assessing officer is erroneous and prejudicial to the interest of revenue. Such issue has not been merged with order of CIT(A). The interest on fixed deposit of Rs.4,21,54,142/- has been taken directly to the 'Reserve and Surplus' in the balance sheet so that tax liability on the said amount may be avoided, hence it is loss to the Revenue. The ld DR also pointed out that since the interest on fixed deposit was not routed through profit and loss account therefore, certainly it is a violation of the accounting principles and hence the order passed by the Ld. PCIT may be upheld.

14. We have heard both the parties and carefully gone through the submissions put forth on behalf of the assessee along with the documents furnished and the case laws relied upon, and perused the facts of the case including the findings of the ld. PCIT and other material brought on record. We have gone through the order of ld PCIT and the direction

given by ld PCIT (vide para 9 of PCIT order) to the assessing officer, which is reproduced below for ready reference:

> *"9.Accordingly, the assessment order u/s 143(3) of the Income-tax Act, 1961 dated 21.12.2019 for A.Y. 2017-18 in the instant case is set aside with a direction to the Assessing Officer to pass fresh assessment order* ***after taking into consideration the issues as may have been already considered together with the issue discussed herein above also.*** *Needless to mention that while passing the fresh assessment order, consequent to this order under section 263 of the I.T. Act, the Assessing Officer shall grant reasonable and sufficient opportunity of being heard to the assessee."*

15. From the above direction of ld PCIT, it is vivid that ld PCIT has directed to the assessing officer to examine those issues ***'as may have been already considered'*** by the assessing officer, and those issues were not the subject matter of revision proceedings u/s 263 by ld PCIT, hence such direction given by ld PCIT is bad in law.

16. On merits, the solitary grievance of ld DR for the Revenue is that interest on fixed deposit of Rs.4,21,54,142/- is assessable under the head 'income from other sources', and such interest income has been earned by the assessee, by way of making fixed deposit, from the surplus and unutilized contribution received from its members. Therefore, as per ld DR contribution received from members is exempted from tax under section 10(20) of the Act, and not the interest on fixed deposit which was earned by the assessee by parking the exempted contribution in the bank by way of fixed deposit and said interest on fixed deposit was not routed through profit and loss account therefore it is a violation of the accounting principles. We do not agree with the proposition canvassed by ld DR for the Revenue. First of all, the bare section 10(20) of the Act, it self includes "income from other sources". The Section 10(20) of the Income Tax Act is reproduced below for ready reference:

> *"(20) the income of a local authority which is chargeable under the head "Income from house property", "capital gains" or "income from other sources" or from a trade or business carried on by it which accrues or arises from the supply of a commodity or service [(not being water or electricity)*

within its own jurisdictional area or from the supply of water or electricity within or outside its own jurisdictional area].

[explanation – For the purposes of this clause, the expression "local authority" means –

(i) Panchayat as referred to in clause (d) of article 243 of the Constitution, or
(ii) Municipality as referred to in clause (e) of article 243P of the Constitution. Or
(iii) Municipal Committee and District Board, legally entitled to, or entrusted by the Government with, the control or management or a Municipal or local fund, or
(iv) Cantonment Board as defined in section 3 of the Cantonments Act, 1942 (2 of 1924);]"

17. From the above, it is vivid that interest income on fixed deposit is to be shown under the head income from other sources, however, such interest income, as per assessee, is to be utilized for achieving the main object of the assessee, hence it is exempted under section 10(20) of the Act.

18. Next grievance of Ld. DR for the Revenue is that said interest on fixed deposit was not routed through profit and loss account therefore it is a violation of the accounting principles. We agree with Ld. DR for the Revenue that there is violation of accounting principles reason being the ***'interest'*** being a revenue receipt should be routed through profit and loss account. However, at the same time, we also note that there is no loss to the revenue. Had such interest income been routed through profit and loss account, then also it would have been exempted from income tax under section 10(20) of the Act. We do agree that there is violation of accounting principles but there is no avoidance of true tax liability. The assessee is working within the four corners of the Income Tax Act and just because the assessee has not followed correct principle of accounting does not mean that assessee is engaged in tax evading practices.

19. The substantial nature and character of the ***interest income on fixed deposit*** does not change just because assessee has not routed the interest income through profit and loss account. The pith and substance of the ***interest income on fixed deposit*** cannot be changed whether it is routed through profit and loss account or taken directly to the reserve and surplus in the balance sheet. There is a famous saying that the ***'tail' cannot wag the 'dog', therefore according to us accounting principles cannot override the Income Tax Act.*** If there is conflict between accounting principles and Income Tax Act, the Income Tax Act will prevail, after all income tax liability of the assessee, is to be determined by following the Income tax Act. The entries in the books of account cannot decide whether a receipt is taxable or not or whether expenses are allowable as deduction or not. Courts are compelled to go by the true nature of the receipts and not go by the entry in the books of account, vide landmark judicial precedent in the case of CIT vs. India Discount Co. Ltd. (1970) 75 ITR 191 (195) and Kedernath Jute Manufacturing Co. Ltd. vs. CIT (1971) 82 ITR 363 (367). Hence, we do not agree with ld DR for the Revenue that because of violation of accounting principles, there is a tax avoidance on the part of the assessee under consideration. Therefore, order passed by the assessing officer is neither erroneous nor prejudicial to the interest of Revenue.

20. We note that similar identical issue by applying the provisions of section 10(20) of the Act, has been decided by the Coordinate Bench of ITAT Chandigarh, in the case of Haryana State Agricultural Marketing Board, 88 taxmann.com 800, wherein it was held as follows:

> *"Section 10(20) of the Income-tax Act, 1961 - Local authority - Assessment years 2000-01 to 2003-04 - Where entire income of assessee has been held to be exempt under section 10(20) there is no case for making disallowance of any expense at all [In favour of assessee]*

Section 10(20) of the Income-tax Act, 1961 - Local authority - Assessment years 2000-01 to 2003-04 - Where assessee was engaged in activity of promotion and development of market committees and in that process undertook capital projects of market committees, income from sale of tender forms and enlistment fees of contractors had direct nexus with main activity carried out by assessee and, therefore, was to be treated as having been earned in course of carrying out its activities and would be exempt under section 10(20) [In favour of assessee]

Section 10(20) of the Income-tax Act, 1961 - Local authority - Assessment years 2000-01 to 2003-04 - Interest earned by assessee, State Agricultural Marketing Board, from funds received from market committees for investing in capital projects, which were held in bank deposits till they were utilised for execution of projects, was assessable under head income from other sources and was exempt under section 10(20) [In favour of assessee]"

21. We are aware of the famous judgment of Hon'ble Apex Court in Malabar Industries Ltd. vs. CIT [2000] 243 ITR 83(SC) wherein their Lordship have held that *twin* conditions needs to be satisfied before exercising revisional jurisdiction u/s 263 of the Act by the Ld. CIT. The twin conditions are that the order of the Assessing Officer must be erroneous and so far as prejudicial to the interest of the Revenue. In the following circumstances, the order of the AO can be held to be erroneous order, that is (i) if the Assessing Officer's order was passed on incorrect assumption of fact; or (ii) incorrect application of law; or (iii)Assessing Officer's order is in violation of the principle of natural justice; or (iv) if the order is passed by the Assessing Officer without application of mind; (v) if the AO has not investigated the issue before him; then the order passed by the Assessing Officer can be termed as erroneous order. Coming next to the second limb, which is required to be examined as to whether the actions of the AO can be termed as prejudicial to the interest of Revenue. When this aspect is examined one has to understand what is prejudicial to the interest of the revenue. The Hon'ble Supreme Court in the case of Malabar Industries (supra) held that this phrase i.e. ***"prejudicial to the interest of the revenue"*** has to be read in conjunction

with an *erroneous order* passed by the Assessing Officer. Their Lordship held that it has to be remembered that every loss of revenue as a consequence of an order of Assessing Officer cannot be treated as prejudicial to the interest of the revenue. When the Assessing Officer adopted one of the courses permissible in law and it has resulted in loss to the revenue, or where two views are possible and the Assessing Officer has taken one view with which the CIT does not agree, it cannot be treated as an erroneous order prejudicial to the interest of the revenue ***"unless the view taken by the Assessing Officer is unsustainable in law".***

22. Taking note of the aforesaid dictum of law laid down by the Hon'ble Apex Court, let us examine assessee`s case. We note that assessee is acting within the four corners of law of the Income Tax and claimed deduction under section 10(20) of the Act, in respect of interest on fixed deposit of Rs.4,21,54,142/- which is assessable under the head 'income from other sources', and the same is exempted under section 10(20) of the Act, hence order passed by the assessing officer is not erroneous. In fact, order passed by the assessing officer is sustainable in law.

23. Apart from this we note that issue of interest on fixed deposit of Rs.4,21,54,142/- which is assessable under the head 'income from other sources', has been examined by the assessing officer during the assessment stage. The assessing officer (AO) issued the notice under section 142(1) of the Act and assessee has filed relevant documents and evidences before the AO. Thus, assessing officer conducted necessary enquiry. A mere observation that no proper details have been obtained, cannot be sufficient to come to a conclusion that the AO did not make proper and adequate inquiries which he ought to have made in the given facts and circumstances of this case. The assessee claimed the exemption

in accordance with the provisions of section 10(20) of the Act. In the conclusion we are of the view that none of the reasons set out by the PCIT for invoking the jurisdiction u/s 263 of the Act are sustainable. The impugned order of the PCIT has to be quashed for the reason that order of the AO sought to be revised in the impugned order was neither erroneous nor prejudicial to the interest of the revenue for the reason of any lack of inquiry that the AO ought to have made in the given facts and circumstances of the case. We accordingly quash the order u/s 263 of the Act and allow the appeal of the assessee.

24. In the result, appeal filed by the assessee is allowed.

Order pronounced on 26/06/2023 in the open court.

Sd/-	**Sd/-**
(PAWAN SINGH)	**(Dr. A.L. SAINI)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

सूरत /Surat
दिनांक/ Date: 26/06/2023
*SAMANTA***
Copy of the Order forwarded to

1. The Assessee
2. The Respondent
3. The CIT(A)
4. CIT
5. DR/AR, ITAT, Surat
6. Guard File

By Order

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Assistant Registrar/Sr. PS/PS
ITAT, Surat