



IN THE INCOME TAX APPELLATE TRIBUNAL, RAJKOT BENCH, RAJKOT
BEFORE DR. ARJUN LAL SAINI, ACCOUNTANT MEMBER

AND

SHRI DINESH MOHAN SINHA, JUDICIAL MEMBER

आयकर अपील सं./ITA No. 37/RJT/2022

(Assessment Year: 2017-18)

(Hybrid Hearing)

Saurashtra Gramin Bank Manager (F & A), 1 st Floor Wing 2, LIC Jeevan Prakash Building, Tagore Road, Rajkot-360001	Vs.	The Pr. CIT-1, Rajkot
स्थायीलेखासं./जीआइआरसं./PAN/GIR No.: AAHAS2116H		
(अपीलार्थी/Appellant)		(प्रत्यर्थी/Respondent)

निर्धारितकीओरसे/Assessee by

: Ms. A.D. Vyas, AR

राजस्वकीओरसे/Revenue by

: Shri Sanjay Punglia, CIT-DR

सुनवाईकीतारीख/ Date of Hearing

: 29/09/2025

घोषणाकीतारीख/Date of Pronouncement

: 30/09/2025

आदेश/ORDER

Per, Dr. Arjun Lal Saini, AM:

By way of this appeal, the assessee has challenged the correctness of the order dated 24.01.2022 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). The grounds raised in this appeal are without prejudice to one another.

2.Order of the learned PCIT Rajkot-1 (hereinafter called as PCIT) reopening the assessment u/s 263 is totally bad on facts as well as in law. Learned PCIT ought to have



considered the fact that the assessee has been duly scrutinized and all the aspects were discussed in detail during the course of the assessment proceedings under section 143(3). So, action of the re-opening of the assessment under section 263 is not justified.

3. The learned PCIT has grievously erred in making conclusion that Assessee is not eligible to claim Provision of Rs. 20,78,36,400/-, on account of Investment Depreciation Reserve (Marked to Market). Learned PCIT has failed to consider the RBI circular No. RBI/2013-14/434 RPCD. CO. RRB. BC. No./ 74 /03.05.33/2013-14 dated January 07, 2014 that "The investments under the Available for Sale and Held for Trading categories should be marked to market". The same fact was clarified by CBDT vide Instruction No. 17/2008, Dated 26-11-2008.

4. Learned PCIT grossly failed to consider the deductions allowable as per the Statute under section 36(1)(viii), 36(1)(v) and 36(1)(viia) amounting to Rs. 46,83,83,284/-.

5. Learned PCIT has failed to consider the fact that your Honour's assessee is a Regional Rural Bank required to furnish details with respect to cash deposit during demonetization period to Reserve Bank of India on daily basis. The Assessee is authorized to deal with receipt and payment of cash.

6. Learned PCIT has grievously erred on calculating the disallowances of Rs. 46,00,000/- under section 14A. He ought to have considered the fact that against average non-interest bearing investment in mutual fund for Rs. 46 crore, as mentioned in the order u/s.263, the Assessee is having share capital and Reserve Fund of Rs. 195 crore. So, the proposed disallowance is not justifiable.

7. In view of the grounds mentioned as above your Appellant requests your Honour to appreciate the fact that re-opening of the assessment as above is completely erroneous and disregard with the Act, and order under section 263 is required to be quashed.

8. Your Honor's appellant craves leave to add, amend, alter or withdraw any or more grounds of appeal before hearing of appeal."

3. The relevant material facts, as culled out from the material on record, are as follows. The return of income for assessment year 2017-18, has been filed by the assessee, on 28/10/2017, disclosing income of Rs.75,50,27,230/-. Thereafter revised return of income was filed on 27-02-2018, declaring total income at Rs. 54,71,90,830/-. The assessment was completed u/s 143(3) of the Income-tax Act, on 29/12/2019, at the returned income.



4. Later on, Learned Principal Commissioner of Income-tax (in short “Ld PCIT”), has exercised his jurisdiction under section 263 of the Income-tax Act, 1961.

5. The Id.PCIT had noticed the first issue from the assessment records that assessee (M/s Saurashtra Gramin Bank) during the previous year 2016-17 relevant to assessment year (A.Y.) 2017-18, had made provision for an amount of Rs. 20,78,36,400/-, on account of "Investment Depreciation Reserve" as allowable expenditure on account of depreciation on investment, however, the nature of deduction is notional in nature and not allowable as an expense as per the provision of the Act. Accordingly, the same should have been disallowed u/s 37(1) of Income Tax Act, and to be added to the total income of the assessee- bank, by the assessing officer, while finalizing the assessment u/s 143(3) of the I. T. Act for the year under consideration.

6. The Id.PCIT had noticed the second issue from the assessment records that assessee, during the assessment proceedings, was requested to furnish various details with respect to cash deposit made by it during demonetization period, however, the Assessee- Bank did not furnish any details with respect to cash deposit. The issue was required to be verified by the assessing officer, while finalizing the assessment u/s 143(3) of the I. T. Act for the year under consideration.

7. The Id.PCIT had noticed the third issue from the assessment records that the Assessee- Bank had made investment in unquoted Bond, which can earn exempt income. The amount of investment made in unquoted Bond was as on 01-04-2016 of Rs.70,00,00,000/- and Rs. 22,00,00,000/-, as on 31-03-



2017. The ld.PCIT observed that the CBDT, vide Circular No. 05/2014 dated 11-02-2014, issued clarification to Rule 8D, r.w.s. 14A of the Act, stating that as per Rule 8D, disallowance of the expenditure can be made even where taxpayer in particular year has not earned any exempt income. The ld. PCIT noted that in assessee's case, the disallowance u/s 14A of the Act is applicable and amount of disallowance as per Rule 8D r.w.s. 14A of the Act, was worked out by ld.PCIT, as under:

As per Rule 8D(2)(i)	Direct expenditure relating to income which does not form part of total income	NIL
As per Rule 8D(2)(ii)	Indirect expenditure - Interest not directly attributable to any particular income or receipt	
Total Investment, which can earn exempt income as on 01-04-2016	Rs. 70,00,00,000/-	
Total Investment, which can earn exempt income as on 31-03-2017	Rs. 22,00,00,000/-	
Average value of Investment (D), income from which is exempt (B)+(C)/2	Rs. 46,00,00,000/-	
1% X average value of investment (Income from which is exempt)	1 % X Rs. 46,00,00,000	Rs.46,00,000
	Total Disallowance	Rs.46,00,000/-

However, the assessing officer while completing the assessment u/s 143(3) of the Act has not properly examined the above issues.

8. The ld.PCIT had noticed the fourth issue from the assessment records, in respect of various deductions claimed by the Assessee- Bank, such as: (i) assessee had claimed the deduction of special reserve u/s 36(1)(vii) of Rs. 6,75,00,000/-, (ii) amount paid by assessee in gratuity fund u/s 36(v) of Rs.



11,50,00,000/-, and (iii) provision for doubtful debts, made by assessee, for rural advances of Rs. 28,58,83,284/-, totaling to Rs. 46,83,83,284/-. However, the assessee has not furnished any details of the computation of above claims or the basis of calculation of the above deductions, despite the facts that assessing officer vide notice u/s 142(1) of the Act, dated 09-08-2019, has called for such details /basis. Even, thereafter also while completing the assessment the assessing officer has ignored this fact and granted the deduction as claimed without verification in absence of any basis /veracity of such claims. Thus, Id.PCIT noticed that an amount of Rs. 46,83,83,284/-, as any other amount allowable as various deductions in column A-32 of schedule BP of the income tax return (ITR) of the assessee, has been shown in the financial statements. However, M/s Saurashtra Gramin Bank (the assessee) had not furnished any detailed computation / basis of calculation of various deductions / claims also not assigned any reasons for non-furnishing of such information. The issue was required to be verified by the assessing officer while finalizing the assessment u/s 143(3) of the I. T. Act, for the year under consideration.

9. In respect of all the above issues, raised by the Id. PCIT, in his revision order, under section 263 of the Act, the learned PCIT observed that assessing officer has not conducted proper enquiries and in the above various issues raised by the learned PCIT, the major revenue stake is involved and these above issues, were not properly verified by the assessing officer. Thus, the Id.PCIT noticed that there was not only the proper verification of facts but also incorrect application of law and the same has rendered the assessment order passed by the assessing officer, under section



143(3) of Act, dated 07.11.2019, as erroneous as well as prejudicial to the interest of the revenue. In view of the above, a show cause notice dated 23/07/2021, was issued to the assessee, proposing to subject the assessment order of the assessing officer to revision u/s 263 of the Income tax Act.

10. In response to the above show cause notice, the assessee has submitted a detailed reply before learned PCIT on 22/12/2021. The assessee submitted about provision of Rs. 20,78,36,400/- on account of Investment Depreciation (MTM) stating that assessee bank had made mark to market provision for an amount of Rs.20,78,36,400/- on account of "Investment Depreciation Reserve" as allowable expenditure on account of depreciation on investment. For this, the assessee submitted the RBI circular No. RBI/2013-14/434 RPCD. CO. RRB. BC. No./ 74 /03.05.33/2013-14 dated January 07, 2014. In the said circular it is stated that the investments under the Available for Sale and Held for Trading categories should be marked to market. Accordingly, whenever, assessee earns profit from the sale of Government security, the same is offered to tax as mentioned in Schedule No. 14. An amount of Rs. 25.34 crore was earned from sale of G-SEC investment from the Available for Sale category. Afterwards, rate of interest of G-sec market rose consequently prices of the G-sec decreased and market value of portfolio under Available for sale reduced, therefore the assessee had to make provision of Rs. 20.78 crore as shown in Schedule 16A of profit of loss account of the bank. Thus, when rate of interest in the G-sec market reduced, prices of G-sec. increased.

Year ending	Provision during year as mentioned in Schedule 16A	Balance (Schedule 5)	O/s.



31-03-2017	Provision made Rs. 20.78 crore	Rs.20.78 crore
31-03-2018	Written back and offered to tax Rs. 6.97 crore	Rs.13.81 crore
31-03-2019	Written back and offered to tax of Rs. 12.62 crore	Rs. 1.19 crore
31-03-2020	Written back and offered to tax Rs. 1.19 crore	Rs. Nil

So, the assessee bank is consistently following the RBI circular, maintaining records and offer the tax accordingly. If proposed addition as mentioned by ld.PCIT amounting to Rs. 20.78 crore made, then amount offered for tax in next years; that is, in assessment year 2018-19, 2019-20 and 2020-21 of Rs. 6.97 Crore, Rs. 12.62 Crore and Rs. 1.19 Crore respectively will have to be reversed which is against the RBI guidelines and accepted accounting principles. The CBDT, vide their Instruction No. 17/2008, Dated 26-11-2008, has also clarified to the assessing officers that:

“(vii) As per RBI guidelines dated 16th October 2000, the investment portfolio of the banks is required to be classified under three categories viz. Held to Maturity (HTM), Held for Trading (HFT) and Available for Sale (AFS). Investments classified under HTM category need not be marked to market and are carried at acquisition cost unless these are more than the face value, in which case the premium should be amortized over the period remaining to maturity. In the case of HFT and AFS securities forming stock in trade of the bank, the depreciation / appreciation is to be aggregated scrip wise and only net depreciation, if any, is required to be provided for in the accounts. The latest guidelines of the RBI may be referred to for allowing any such claims.”



Based on the above clarifications, the assessee stated before Id.PCIT that proposed addition is without any base and in contravention to accounting principles and RBI guidelines which, bank is supposed to follow.

11. About amount Rs. 46,83,83,284/- claimed as any other amount allowable as deductions, under various sections noted below. The assessee submitted the details as follows:

Sr.	Description	Amount Rs.
(i)	Special Reserve allowable u/s 36(1)(viii)	Rs. 6,75,00,000/-
(ii)	Amount paid in gratuity/LE fund - allowable u/s 36(v)	Rs. 11, 50,00,000/-
(iii)	Provision for bad and doubtful debt for rural advances allowable u/s 36(1)(viia)	Rs. 28,58,83, 284/-
	Total	Rs.46,83,83,284/-

The assessee also explained the provisions of section 36(1)(viii) of the Income Tax Act, which is reproduced here under:

“Other deductions, (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—

“(viii) in respect of any special reserve created and maintained by a specified entity, an amount not exceeding twenty per cent of the profits derived from eligible business computed under the head “Profits and gains of business or profession” (before making any deduction under this clause) carried to such reserve account”

Calculation of the deduction under section 36(1)(viii) of the Act was submitted by the assessee before Id.PCIT, which is given here under:



Sr.	Description	Total Long Term eligible loans Avg. O/s. Rs.	Total Interest earned Rs. on these eligible segment	% Yield/cost on this Long Term Advances
1	(1) Total eligible loans (avg. for the year)	7213786887	869572589	12.05%
	Less :			
2	Avg. Cost of fund	7213786887	385937598	-5.35%
3	Avg. operating Expenditure cost	7213786887	143152004	-1.98%
	Add:-			
4	Avg. Other Income (Excl. profit on sale of investment)	7213786887	49202638	0.68%
5	Net Operating cost (3)-(4)			-1.30%.
6	Net Margin on these Advances	7213786887	389685625	5.40%
7	Sp. Provision allowable @ 20% of Net profit of such advances		77937125	
8	Special reserve made in		67500000	



	FY 2016-17			
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12. About amount paid in gratuity fund amounting to Rs. 11,50,00,000/- allowable u/s 36(1)(v) as under:

“Under section 36(1)(v) of the Act, any sum paid by the assessee as an employer by way of contribution towards an approved gratuity fund created by him for the benefit of his employees under an irrevocable trust is allowable as a deduction in the computation of income from business/profession.

Amount is allowable on payment basis. So, assessee had added back the provision for gratuity in its computation of income and deduct the payment in gratuity fund on actual payment basis. The details of actual payment receipt are as follows:

<i>SBI Life Insurance Co.</i>	<i>Rs. 1,75,00,000/-</i>
<i>SBI Life Insurance Co.</i>	<i>Rs. 8,25,00,000/-</i>
<i>India First Life Insurance Co.</i>	<i>Rs. 1,50,00,000/-</i>
<i>Total</i>	<i>Rs. 11,75,00,000/-</i>

13. About provision for bad and doubtful debt for rural advances allowable u/s 36(1)(viiia) in respect of any provision for bad and doubtful debts made by:

“(a) a scheduled bank [not being a bank incorporated by or under the laws of a country outside India or a non-scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank], an amount not exceeding [eight and one-half per cent] of the total income (computed before making any deduction under this clause and Chapter VIA) and an amount not exceeding ten per cent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner :



Out of assessee`s 251 total Branches, 155 Branches are Rural Branches only. At the end of March-2017, advances of all branches stood at Rs. 2675. 23 crore and Average advances of all branches for the year 2016-17 stood at Rs. 2445.98 crore. Likewise, the end of March-2017; advances of Rural branches stood at Rs. 1471. 95 crore and Average advances of Rural branches for the year 2016-17 stood at Rs. 1425.73 crore.

If assessee considers, merely an amount of ten per cent of the aggregate average advances of Rs. 1425.73 crore made by the rural branches of its bank, it stands at Rs. 142.57 crore plus eight and one-half per cent of total income can also be added therein. Branch-wise Advances of all branches at the end of each month of F.Y.2016-17 starting from Apr-16 to March-17 is given in the annexure. Moreover, average -Advances of all branches as well as Rural. All these details were submitted by the assessee, before the assessing officer.

14. About details regarding cash deposit, the assessee submitted that he required to furnish details of (Specified Bank Notes) SBN of Rs.500 and Rs.1000 with respect to cash deposit made by assessee during demonetization period to Reserve Bank of India on daily basis. Accordingly, assessee has regularly submitted the report to Reserve Bank of India during de monetization period. The assessee is the public sector bank formed under the Regional Rural Bank Act-1976 and included in the schedule-2. The assessee is authorised to deal with receipt and payment of cash. Copy of the notification dated.02-01-2006 was submitted by the assessee.



15. About investment in unquoted bonds and disallowance under section 14A of the Act, the assessee submitted that assessee is in banking business and had made investment in liquid mutual funds. The amount of investment made in liquid mutual funds as on 01-04-2016 for Rs. 70 crore and as on 31-03-2017, it was Rs. 22 crores. The assessee submitted that investments are made as part of banking business. Raising funds, lending and investment thereof is an integrated business of bank as defined in the Banking Regulation Act. Besides tax free investments are made from spare funds which are lying at the Reserve and surplus and share Capital. Borrowed funds and deposits are not invested in such securities. The figures of non-interest bearing funds as on 31.03.2016 is as under:

Share Capital	Rs. 2453 Lakh
Reserves & Surplus	Rs.17144 Lakh
Total	Rs. 19597 Lakh

As against, the same tax free investment was Rs. 70 Lakh, as on 01.04.2016 and Rs. 22 Lakh as on 31.03.2017. Bombay High Court has recently decided the issue in the favour of the assessee in the case of Commissioner of Income Tax-2, Mumbai 400 020 v/s. HDFC Ltd and held that if there be interest-free funds available to an assessee, sufficient to meet its investments and at the same time the assessee had raised a loan it can be presumed that the investments were from the interest-free funds available.



16. However, learned PCIT rejected the above contention of the assessee and observed that two essential conditions for invoking the provisions of section 263 of I.T. Act are that the order passed by the assessing officer is erroneous and prejudicial to the interest of revenue. It is evident from the above that the assessing officer has failed to examine the fact whether the interest bearing funds has been utilized for the purpose of investment in tax free bonds. No such verification carried out, has been found from the records. Thus, there is lack of verification/inquiry at the part of the assessing officer on the issue under consideration during the course of assessment proceedings. Similarly, the assessing officer has not examined the eligibility of the various deductions claimed by the assessee u/s 36(1)(viii), 36(v), 36(1) (viia) and investment depreciation reserve as mentioned above in spite of the fact that the assessee totally failed to submit the details required by him vide notice u/s 142(1) of I.T. Act. The ld.PCIT also observed that during the course of present proceedings, under section 263 of the Act, the assessee has first time submitted the written submission of seven pages along with its enclosures, which is subject to verification/examination with the records and provisions of law. In view of the above facts, the impugned assessment order is held to be erroneous, as the same was passed without proper verification / examination of facts and law and it is prejudicial to the interest of revenue, as income was under assessed, leading to loss of revenue. The ld.PCIT also noted that there was incorrect application of law also. It is settled position that incorrect application of law constitutes an error and as such the assessment is erroneous and prejudicial to the interests of the Revenue since there is loss of revenue. The ld.PCIT also noted that as per the explanation 2, of section 263 of the Act, the order passed by the



Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interest of the revenue, if the order is passed allowing any relief without inquiring into the claim. However, the assessing officer did not conduct any such inquiries or verification and simply accepted the assessee's claims. In this manner, the assessee's case is also covered under para 'a' of Explanation 2, of section 263(1) of I. T. Act. Therefore, the order passed by the assessing officer is erroneous and prejudicial to the interest of revenue to that extent. Keeping in view these facts, the ld.PCIT set aside the assessment order and directed to the assessing officer to pass assessment order only after proper verification and due application of law to the extent of the issues discussed (supra).

17. Aggrieved by the order of the learned PCIT, the assessee is in appeal before us.

18. Ms. A.D. Vyas, Learned Counsel for the assessee, begins by pointing out that in respect, of all the issues raised by the learned PCIT, the assessee submitted its reply with documentary evidences before the assessing officer. In response to the show cause notice, the assessee has submitted a detailed reply before learned PCIT also, on 22/12/2021. The ld.Counsel stated about provision of Rs. 20,78,36,400/- on account of Investment Depreciation (MTM) that these investments are kind of stock and trade, and assessee - bank had made mark to market provision for an amount of Rs.20,78,36,400/- on account of "Investment Depreciation Reserve" which is allowable expenditure. The ld. Counsel for this relied on the RBI circular No. RBI/2013-14/434 RPCD. CO. RRB. BC. No./ 74 /03.05.33/2013-14 dated



January 07, 2014. In the subsequent year, such amount was offered for tax hence, there is no loss of revenue.

19. Ms. A.D. Vyas, Learned Counsel for the assessee, argued about second issue that amount Rs. 46,83,83,284/- claimed as any other amount allowable as deductions, under various sections, such as Special Reserve allowable, under section 36(1)(viii) Rs. 6,75,00,000/-, Amount paid in gratuity/LE fund allowable under section 36(v) Rs. 11, 50,00,000/-, and Provision for bad and doubtful debt for rural advances allowable under section 36(1)(viia) Rs. 28,58,83, 284/-, total of all these amounts come to Rs. 46,83,83,284/-, which were claimed by the assessee, as per the above respective provisions of the Income Tax Act, hence there is no loss of revenue.

20. Ms. A.D. Vyas, Learned Counsel for the assessee, argued about third issue of details regarding cash deposit, that assessee-bank required to furnish details of (Specified Bank Notes) SBN of Rs.500 and Rs.1000 with respect to cash deposit made by assessee during demonetization period to Reserve Bank of India on daily basis. Accordingly, assessee has regularly submitted the report to Reserve Bank of India during de monetization period as per the guidelines issued by the RBI, hance order passed by the assessing officer should not be erroneous on this issue.

21. Ms. A.D. Vyas, Learned Counsel for the assessee, argued about third issue pertaining to section 14A read with rule 8D of the Rules, stating that tax free investments are made from surplus funds which are lying at the



Reserve and surplus and share Capital of the Assessee- Bank, therefore on this issue order passed by the assessing officer should not be erroneous.

22. Ms. A.D. Vyas, Learned Counsel for the assessee, also argued that in respect of all the issues raised by the learned PCIT, the assessing officer during the assessment proceedings issued the notice under section 142(1) of the Act and in response to the notice of the assessing officer, the assessee submitted, required details and documents before the assessing officer, therefore, assessing officer examined, the each and every issue raised by the ld.PCIT and applied his mind and thereafter framed the assessment order. Just because assessing officer framed the assessment order in brief does not mean that assessing officer does not apply his mind to examine all the issues raised by the learned PCIT. Therefore, learned Counsel submitted that order passed by the assessing officer is neither erroneous nor prejudicial to the interest of the revenue. Therefore, revision of jurisdiction exercised by the ld. PCIT may be quashed.

23. On the other hand, learned DR for the revenue argued about the first issue stating that during the assessment year (A.Y.) 2017-18, assessee had made provision for an amount of Rs. 20,78,36,400/-, on account of "Investment Depreciation Reserve" , which is notional expenses. That is, the nature of deduction is notional in nature and not allowable as an expense as per the provision of the Act, therefore order passed by the assessing officer is erroneous.



24. Learned DR for the revenue argued about the second issue stating that report of cash deposit made by bank during demonetization period, was not submitted by the bank. That is, the Assessee- Bank did not furnish any details with respect to cash deposit before the assessing officer. Hence, assessing officer has not examined this fact, whether the bank was submitting its report to the RBI on day-to-day basis during the demonetization period.

25. Learned DR for the revenue argued about the third issue stating that the Assessee- Bank had made investment in unquoted Bond, which can earn exempt income. The amount of investment made in unquoted Bond was as on 01-04-2016 of Rs.70,00,00,000/- and Rs. 22,00,00,000/-, as on 31-03-2017. As per the CBDT, vide Circular No. 05/2014 dated 11-02-2014, issued for clarification to Rule 8D, r.w.s. 14A of the Act, that as per Rule 8D, disallowance of the expenditure can be made even where taxpayer in particular year has not earned any exempt income. Since, the assessing officer has not followed the CBDT circular. Hence, order passed by the assessing officer is erroneous as well as prejudicial to the interest of the revenue.

26. Learned DR for the revenue argued about the fourth issue stating that various deductions were claimed by the Assessee- Bank, such as: (i) deduction of special reserve u/s 36(1)(vii) of Rs. 6,75,00,000/-, (ii) Gratuity fund- deduction u/s 36(v) of Rs. 11,50,00,000/-, and (iii) deduction on account of provision for doubtful debts, made by assessee, for rural advances of Rs. 28,58,83,284/-, totaling to Rs. 46,83,83,284/-. The assessee has not



furnished any details of the computation of above claims or the basis of calculation of the above deductions, therefore assessing officer without verification of these deductions allowed the claim of the assessee, therefore, order passed by the assessing officer is erroneous and prejudicial to the interest of the revenue.

27. We have heard the rival contentions, perused the material on record and duly considered facts of the case in the light of the applicable legal position.

28. So far, the first issue about provision of Rs. 20,78,36,400/- on account of Investment Depreciation (MTM) is concerned, we note that assessee bank had made mark to market provision for an amount of Rs.20,78,36,400/- on account of "Investment Depreciation Reserve" as allowable expenditure on account of depreciation on investment, as these investments includes the securities, "held for trading" and "available for sale", which the assessee - bank is treating as a part of stock. As per Banking Regulations and RBI Guidelines, the banks must classify their investment portfolio into three categories:

(i)Held to Maturity (HTM) – carried at cost, no marking to market, except amortization of premium.

(ii)Held for Trading (HFT) and

(iii)Available for Sale (AFS)

As per accounting policy of the bank, HFT and AFS, form part of stock-in-trade. The valuation of these investments are done at **market price**, and



depreciation or loss, if any, is charged to Profit & Loss account. Thus, banks are required to recognize losses on account of depreciation/loss on valuation. The treatment under the Income tax Act, what matters, is the real income principle and method of accounting. However, as we have noted that Banks treat HFT & AFS securities as **stock-in-trade** (not capital assets). The Valuation of stock-in-trade at lower of cost or market value is a recognized method under accounting standards and consistently upheld by courts. That is, various Courts and Tribunals have consistently allowed depreciation on valuation of securities held as stock-in-trade by banks. The Hon`ble Supreme Court in the case of UCO Bank v. CIT (1999) 237 ITR 889 (SC) – held that depreciation on securities held as stock-in-trade is allowable. The RBI guidelines for valuation are binding for banks, and such losses are deductible. The Hon`ble Bombay High Court in the case of CIT v. Bank of Baroda (2003) 262 ITR 334 (Bom HC), held that loss on valuation of securities held as stock-in-trade is deductible. Therefore, depreciation/loss on HFT and AFS securities is allowable as a deduction under the Income-tax Act, 1961, because they are treated as stock-in-trade. Hence, we note that the assessing officer has examined these aspects during the assessment proceedings. Therefore, order passed by the assessing officer is not erroneous.

29. We note that the RBI circular No. RBI/2013-14/434 RPCD. CO. RRB. BC. No./ 74 /03.05.33/2013-14 dated January 07, 2014, states that the investments under the Available for Sale and Held for Trading categories should be marked to market. Accordingly, whenever, assessee earns profit from the sale of Government security, the same is offered to tax as



mentioned in Schedule No. 14 of the assessee-bank. Therefore, the assessee bank is consistently following the RBI circular, maintaining records and offer for tax accordingly on account of held for trading and available for sale securities. The assessee also submitted before the learned PCIT that if proposed addition as mentioned by ld.PCIT amounting to Rs. 20.78 crore made, then amount offered for tax in next years; that is, in assessment year 2018-19, 2019-20 and 2020-21 of Rs. 6.97 Crore, Rs. 12.62 Crore and Rs. 1.19 Crore respectively will have to be reversed which is against the RBI guidelines and accepted accounting principles. We note that Reserve Bank of India (RBI), issued circular to all regional rural banks, vide circular number RBI/2013-14/434/RPCD.CO.RRB.BC.No.74 dated 07.01.2014, about classification of these securities, which are reproduced below:

"Guidelines for Classification and Valuation of Investments

Please refer to our circular RPCD.RRB.BC.No.59/03.05.34/2010-11 dated April 11, 2011, in terms of which RRBs were exempted from 'Mark to Market' (MTM) norms in respect of their entire investment in SLR securities, upto the financial year 2012-13. It has now been decided to withdraw the exemption from MTM norms given to RRBs in respect of the entire portfolio of SLR securities. Accordingly, RRBs are advised to introduce MTM norms in respect of SLR securities w.e.f. April 01, 2014.

2. *The revised guidelines on classification and valuation of investments are furnished in the Annex. The salient features of the revised guidelines are as under :*



- *RRBs are required to classify their entire investment portfolio, as on April 01, 2014 under three categories viz. 'Held to Maturity', 'Available for Sale' and 'Held for Trading'.*
- *In the balance sheet, the investments will continue to be disclosed as per the existing five classifications viz. i) Government securities ii) Other approved securities iii) Shares iv) Debentures & Bonds v) Others (Mutual Fund Units, etc.).*
- *The investments included under 'Held to Maturity' should not exceed 25 per cent of the bank's total investments. The limit can be exceeded if the excess comprises SLR securities and the total SLR securities held in the HTM category is not more than 24.5 per cent of their DTL as on the last Friday of the second preceding fortnight.*
- *The investments under the Available for Sale and Held for Trading categories should be marked to market periodically as indicated in the Annex.*
- *The investments under the Held to Maturity category need not be marked to market as in the case of 'Permanent' securities at present.*
- *Classification of investments, shifting of investments among the three categories, valuation of the investments, methodology for booking profit/loss on sale of investments and providing for depreciation should be in accordance with the guidelines in the Annex.*
- *The risk-weights assigned to the various securities at present would remain unchanged.*

2.1 The classification of the existing investments among the three categories may be done at the book value of the respective securities as on



April 01, 2014. Subsequent valuation of the securities included under the Held for Trading and the Available for Sale categories may be carried out as specified in the revised guidelines. The first such revaluation may be done, as on April 01, 2014, for the securities under the Held for Trading and Available for Sale categories.

2.2 RRBs should formulate an Investment Policy with the approval of their Board of Directors to take care of the requirements on classification, shifting and valuation of investments under the revised guidelines. Besides, the Policy should adequately address risk-management aspects, ensure that the procedures to be adopted by the banks under the revised guidelines are consistent, transparent and well documented to facilitate easy verification by inspectors and statutory auditors.”

30. Apart from this, the detailed guidelines of the reserve Bank of India for classification of investments and valuation of various investments are reproduced below for better understanding the facts of the assessee`s case under consideration:

“Guidelines for Classification and Valuation of Investment by RRBs

1. Categorisation

The entire investment portfolio of the RRBs comprising SLR securities and non-SLR securities will be classified under three categories viz. ‘Held to Maturity’, ‘Available for Sale’ and ‘Held for Trading’. However, in the Balance Sheet, the investments will continue to be disclosed as per the existing five classifications viz. (1) Government Securities (2) Other



approved securities (iii) Shares (iv) Debentures & Bonds (v) Others like Mutual Fund units, etc. RRBs should decide the category of the investment at the time of acquisition and the decision should be recorded on the investment proposals.

1.1 Definitions

The securities acquired by the RRBs with the intention to hold them up to maturity will be classified under Held to Maturity (HTM). The securities acquired by the RRBs with the intention to trade by taking advantage of the short-term price/interest rate movements will be classified under Held for Trading (HFT). The securities which do not fall within the above two categories will be classified under Available for Sale (AFS).

1.2 Held to Maturity

i. The investments included under 'Held to Maturity' should not exceed 25 per cent of the bank's total investments. However, RRBs are permitted to exceed the limit of 25 per cent of their total investments under HTM category provided:

- a) the excess comprises only of SLR securities and*
- b) the total SLR securities held in the HTM category is not more than 24.5 per cent of their DTL as on the last of the second preceding fortnight.*

ii. Profit on sale of investments in this category should be first taken to the Profit & Loss Account and thereafter be appropriated to the 'Capital Reserve Account'. Loss on sale will be recognized in the Profit & Loss Account.

iii. No Non-SLR securities are permitted to be included in HTM.



1.3 Available for Sale & Held for Trading

- i. RRBs will have the freedom to decide on the extent of holdings under Available for Sale and Held for Trading. This will be decided by them after considering various aspects such as basis of intent, trading strategies, risk management capabilities, tax planning, manpower skills, capital position.*
- ii. The investments classified under Held for Trading category would be those from which the RRB expects to make a gain by the movement in the interest rates / market rates. These securities are to be sold within 90 days.*
- iii. Profit or loss on sale of investments in HFT & AFS categories will be taken to the Profit & Loss account.*

2. Shifting among categories

- i. RRBs may shift investments to/from HTM category with the approval of the Board of Directors once a year. Such shifting will normally be allowed at the beginning of the accounting year. No further shifting to/from this category will be allowed during the remaining part of that accounting year.*
- ii. The RRBs may shift investments from AFS to HFT category with the approval of their Board of Directors/ALCO/Investment Committee. In case of exigencies, such shifting may be done with the approval of the Chairman of the bank, but should be ratified by the Board of Directors/ALCO.*
- iii. Shifting of investments from HFT to AFS category is generally not allowed. However, it will be permitted only under exceptional*



- circumstances like not being able to sell the security within 90 days due to tight liquidity conditions, or extreme volatility, or market becoming unidirectional, with the approval of the Board of Directors/ALCO/Investment Committee.*
- iv. *Transfer of scrips from one category to another, under all circumstances, should be done at the acquisition cost/book value/market value on the date of transfer, whichever is the least, and the depreciation, if any, on such transfer should be fully provided for.*
- v. *Transfer of scrips from AFS / HFT category to HTM category should be made at the lower of book value or market value. In other words, in cases where the market value is higher than the book value at the time of transfer, the appreciation should be ignored and the security should be transferred at the book value. In cases where the market value is less than the book value, the provision against depreciation held against this security (including the additional provision, if any, required based on valuation done on the date of transfer) should be adjusted to reduce the book value to the market value and the security should be transferred at the market value.*
- vi. *In the case of transfer of securities from HTM to AFS / HFT category:*
- (a) If the security was originally placed under the HTM category at a discount, it may be transferred to AFS / HFT category at the acquisition price / book value. (It may be noted that as per existing instructions banks are not allowed to accrue the discount on the securities held under HTM category and, therefore, such securities would continue to be held at the acquisition cost till maturity).*



After transfer, these securities should be immediately re-valued and resultant depreciation, if any, may be provided.

(b) If the security was originally placed in the HTM category at a premium, it may be transferred to the AFS / HFT category at the amortised cost. After transfer, these securities should be immediately re-valued and resultant depreciation, if any, may be provided.

vii. In the case of transfer of securities from AFS to HFT category or vice-versa, the securities need not be re-valued on the date of transfer and the provisions for the accumulated depreciation, if any, held may be transferred to the provisions for depreciation against the HFT securities and vice-versa.

3. Valuation of Investments

3.1 Valuation Standards

i. Investments classified under Held to Maturity category need not be marked to market and will be carried at acquisition cost unless it is more than the face value, in which case the premium should be amortised over the period remaining to maturity. The banks should reflect the amortised amount in schedule 13-Interest earned: item II – Income on investments as a deduction. However, the deduction need not be disclosed separately. The book value of the security should continue to be reduced to the extent of the amount amortised during the relevant accounting period.

ii. The individual scrips in the Available for Sale category will be marked to market at quarterly or at more frequent intervals. The book value



of the individual securities would not undergo any change after the revaluation.

iii. The individual scrips in the Held for Trading category will be marked to market at monthly or at more frequent intervals. The book value of individual securities in this category would not undergo any change after marking to market.

Note: Securities under AFS & HFT shall be separately valued scrip-wise and depreciation/appreciation shall be aggregated for each balance sheet classification referred to in para 1 above. The investment in a particular classification may be aggregated for the purpose of arriving at net depreciation/appreciation of investments under that category. Net depreciation, if any, shall be provided for. Net appreciation, if any, should be ignored. Net depreciation required to be provided for, in any one classification should not be reduced on account of net appreciation in any other classification.

The provisions required to be created on account of depreciation in the AFS and HFT category in any year should be debited to the Profit and Loss Account and an equivalent amount (net of tax benefit, if any, and net of consequent reduction in the transfer to Statutory Reserve) or the balance available in the Investment Fluctuation Reserve (IFR) Account, whichever is less, shall be transferred from the IFR Account to the Profit and Loss Account. In the event provisions created on account of depreciation in the AFS and HFT category are found to be in excess of the required amount in any year, the excess should be credited to the Profit and Loss Account and an equivalent amount (net of taxes, if any, and net of transfer to Statutory



Reserves as applicable to such excess provision), should be appropriated to the IFR Account to be utilised to meet future depreciation requirement for investments in this category. The amounts debited to the Profit and Loss Account for provision and the amount credited to the Profit and Loss Account for reversal of excess provision should be debited and credited respectively under the head 'Expenditure - Provisions & Contingencies'. The amounts appropriated from the Profit and Loss Account and the amount transferred from the IFR Account to the Profit and Loss Account should be shown as "below the line" items after determining the profit for the year. The IFR Account should be shown as a separate item in Schedule 2 "Reserves and Surplus" under the Head "Revenue and other Reserves".

3.2 Market Value

(A) Quoted Securities

The 'market value' for the purpose of periodical valuation of investments included in the Available for Sale and the Held for Trading categories would be the market price of the scrip as available from the trades/quotes on the stock exchanges, SGL account transactions, price list of RBI, prices declared by Primary Dealers Association of India (PDAI) jointly with the Fixed Income Money Market and Derivatives Association of India (FIMMDA) periodically.

(B) Unquoted SLR securities

In respect of unquoted securities, the procedure as detailed below should be adopted.



a) **Central Government Securities:**

i. *The banks should value the unquoted Central Government securities on the basis of the prices/YTM rates put out by the PDAI/ FIMMDA at periodical intervals.*

ii. *The 6.00 per cent Capital Indexed Bonds may be valued at "cost" as defined in circular DBOD.No.BC.8/12.02.001/97-98 dated January 22, 1998 and BC.18/12.02.001/2000-01 dated August 16, 2000.*

iii. *Treasury Bills should be valued at carrying cost.*

b) **State Government Securities:**

i. *State Government securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/FIMMDA periodically.*

c) **Other Approved Securities:**

i. *Other approved securities will be valued applying the YTM method by marking it up by 25 basis points above the yields of the Central Government Securities of equivalent maturity put out by PDAI/FIMMDA periodically.*

(C) **Unquoted non-SLR securities**

a) **Debentures/Bonds:**

All debentures/bonds should be valued on the YTM basis. Such debentures/bonds may be of different companies having different ratings.



These will be valued with appropriate markup over the YTM rates for Central Government securities as put out by PDAI/FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the debentures/bonds by the rating agencies subject to the following :

- i. The rate used for the YTM for rated debentures/bonds should be at least 50 basis points above the rate applicable to a Government of India loan of equivalent maturity.*
- ii. Where the debenture/bonds is quoted and there have been transactions within 15 days prior to the valuation date, the value adopted should not be higher than the rate at which the transaction is recorded on the stock exchange.*

b) *Special Securities:*

Special securities directly issued by the Government of India to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 basis points above the corresponding yield on GOI securities. At present, such special securities comprise Oil Bonds, Fertiliser Bonds, bonds issued to the State Bank of India (during recent rights issue), Unit Trust of India, Industrial Finance Corporation of India Ltd., Food Corporation of India, Industrial Development Bank of India Ltd., the erstwhile Industrial Development Bank of India and the erstwhile Shipping Development Finance Corporation.

c) *Preference Shares:*

The valuation of preference shares should be on YTM basis. The preference shares will be issued by companies with different ratings. These will be valued with appropriate mark-up over the YTM rates for Central



Government securities put out by the PDAI/FIMMDA periodically. The mark-up will be graded according to the ratings assigned to the preference shares by the rating agencies subject to the following:

i. The YTM rate should not be lower than the coupon rate/YTM for a GOI loan of equivalent maturity.

ii. Where preference dividends are in arrears, no credit should be taken for accrued dividends and the value determined on YTM should be discounted by at least 15% if arrears are for one year, and more if arrears are for more than one year. The depreciation/provision requirement arrived at in the above manner in respect of nonperforming shares where dividends are in arrears shall not be allowed to be set-off against appreciation on other performing preference shares.

iii. The preference shares should not be valued above its redemption value.

iv. When a preference share has been traded on stock exchange within 15 days prior to the valuation date, the value should not be higher than the price at which the share was traded.

d) Equity Shares:

Equity shares in the RRB's portfolio should be marked to market preferably on a daily basis but at least on a weekly basis. Equity shares for which current quotations are not available or where the shares are not quoted on the stock exchanges, should be valued at break-up value (without considering 'revaluation reserves', if any) which is to be ascertained from



the company's latest balance sheet (which should not be more than one year prior to the date of valuation). In case the latest balance sheet is not available the shares are to be valued at Re. 1 per company.

e) *Mutual Fund Units:*

Investment in quoted Mutual Fund Units should be valued as per Stock Exchange quotations. Investment in un-quoted Mutual Fund Units is to be valued on the basis of the latest re-purchase price declared by the Mutual Fund in respect of each particular Scheme. In case of funds with a lock-in period, where repurchase price/market quote is not available, units could be valued at NAV. If NAV is not available, then these could be valued at cost, till the end of the lock-in period. Wherever the repurchase price is not available the units could be valued at the NAV of the respective scheme.

3.3 Non-Performing Investments (NPI)

3.3.1 In respect of securities included in any of the three categories where interest/ principal is in arrears, the banks should not reckon income on the securities and should also make appropriate provisions for the depreciation in the value of the investment. The banks should not set-off the depreciation requirement in respect of these non-performing securities against the appreciation in respect of other performing securities.

3.2.2 An NPI, similar to a non performing advance (NPA), is one where:

i. Interest/ installment (including maturity proceeds) is due and remains unpaid for more than 90 days.



ii. *The above would apply mutatis-mutandis to preference shares where the fixed dividend is not paid. If the dividend on preference shares (cumulative or noncumulative) is not declared/paid in any year it would be treated as due/unpaid in arrears and the date of balance sheet of the issuer for that particular year would be reckoned as due date for the purpose of asset classification.*

iii. *In the case of equity shares, in the event the investment in the shares of any company is valued at Re.1 per company on account of the non availability of the latest balance sheet, those equity shares would also be reckoned as NPI.*

iv. *If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities, including preference shares issued by the same issuer would also be treated as NPI and vice versa. However, if only the preference shares are classified as NPI, the investment in any of the other performing securities issued by the same issuer may not be classified as NPI and any performing credit facilities granted to that borrower need not be treated as NPA.*

4. General

4.1 Income recognition

i. *Banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest and repayment of principal have been guaranteed by the Central Government or a State Government, provided interest is serviced regularly and as such is not in arrears.*



ii. *Banks may book income from dividend on shares of corporate bodies on accrual basis provided dividend on the shares has been declared by the corporate body in its Annual General Meeting and the owner's right to receive payment is established.*

iii. *Banks may book income from Government Securities and bonds and debentures of corporate bodies on accrual basis, where interest rates on these instruments are predetermined and provided interest is serviced regularly and is not in arrears.*

iv. *Banks should book income from units of mutual funds on cash basis.*

4.2 Broken Period Interest

Banks should not capitalise the Broken Period Interest paid to seller as part of cost, but treat it as an item of expenditure under P&L Account in respect of investments in Government and other approved securities. It is to be noted that the above accounting treatment does not take into account the tax implications and, hence, the banks should comply with the requirements of Income Tax Authorities in the manner prescribed by them.

4.3 Dematerialised Holding

Banks should settle the transactions in securities as notified by SEBI only through depositories. After the commencement of mandatory trading in dematerialised form, banks would not be able to sell the shares of listed companies if they were held in physical form. In order to extend the dematerialised form of holding to other instruments like bonds, debentures and equities, RRBs are permitted to make fresh investments and hold bonds



and debentures only in dematerialised form. Outstanding investment in scrip forms are also required to be converted in dematerialised form.”

31. Moreover, the issue raised by the learned PCIT is covered in favour of the assessee by the judgement of the Coordinate Bench of ITAT Ahmedabad in the case of Maninagar Co. Op. Bank Ltd. Vs DCIT, Circle-6(1), Ahmedabad ITA No. 1584/Ahd/2018 for Assessment Year 2012-13, wherein it was held that depreciation on AFS is an allowable claim. Considering these facts and circumstances, we note that first issue raised by the learned PCIT in his revision order should be quashed, and accordingly, we quash the same, as the order passed by the assessing officer, is sustainable in the eye of law.

32. About second issue raised by the learned PCIT, we note that amount Rs. 46,83,83,284/- claimed as any other amount allowable as deductions, under various sections, such as Special Reserve allowable, under section 36(1)(viii) Rs. 6,75,00,000/-, Amount paid in gratuity/LE fund allowable under section 36(v) Rs. 11, 50,00,000/-, and Provision for bad and doubtful debt for rural advances allowable under section 36(1)(viia) Rs. 28,58,83, 284/-, total of all these amounts come to Rs. 46,83,83,284/-, which were claimed by the assessee, as per the above respective provisions of the Income tax Act. We have examined the paper book of the assessee and computation of total income and noted that these statutory deductions and provisions, were claimed by the assessee as per the respective provisions of the Income tax Act 1961, as noted above, therefore we find merit in the submissions of learned Counsel for the assessee and hence the order passed



by the assessing officer is neither erroneous nor prejudicial to the interest of the revenue.

33. About third issue regarding cash deposit, we note that the assessee submitted required details of (Specified Bank Notes) SBN of Rs.500 and Rs.1000 with respect to cash deposit made, during demonetization period, and information was submitted by the assessee to Reserve Bank of India on daily basis, hence order passed by the assessing officer should not be erroneous on this account.

34. Regarding fourth issue raised by the learned PCIT, we noticed that amount of investment made in liquid mutual funds as on 01-04-2016 for Rs. 70 crore and as on 31-03-2017, it was Rs. 22 crores. The assessee submitted that investments are made as part of banking business. Raising funds, lending and investment thereof is an integrated business of bank as defined in the Banking Regulation Act. Besides tax free investments are made from spare funds which are lying at the Reserve and surplus and share Capital of the assessee bank hence, order passed by the assessing officer should not be erroneous.

35. We also note that assessee during the assessment stage has submitted all the documents, details and the explanations required by the Assessing Officer and just because the Assessing Officer does not bring these facts in his assessment order does not mean that assessing officer has not conducted proper enquiry during the assessment stage. In this regard, the reliance can be placed on the judgment of Hon'ble Delhi High Court in the case of CIT



vs. Sunbeam Auto Ltd. [189 Taxman 436 (Del.)], wherein it was held as follows:

“12. We have considered the rival submissions of the counsel on the other side and have gone through the records. The first issue that arises for our consideration is about the exercise of power by the Commissioner of Income-tax under section 263 of the Income-tax Act. As noted above, the submission of learned counsel for the revenue was that while passing the assessment order, the Assessing Officer did not consider this aspect specifically whether the expenditure in question was revenue or capital expenditure. This argument predicates on the assessment order which apparently does not give any reasons while allowing the entire expenditure as revenue expenditure. However, that by itself would not be indicative of the fact that the Assessing Officer had not applied his mind on the issue. There are judgments galore laying down the principle that the Assessing Officer in the assessment order is not required to give detailed reason in respect of each and every item of deduction, etc. Therefore, one has to see from the record as to whether there was application of mind before allowing the expenditure in question as revenue expenditure. Learned counsel for the assessee is right in his submission that one has to keep in mind the distinction between "lack of inquiry" and "inadequate inquiry". If there was any inquiry, even inadequate, that would not by itself, give occasion to the Commissioner to pass orders under section 263 of the Act, merely because he has different opinion in the matter. It is only in cases of "lack of inquiry", that such a course of action would be open. In Gabriel India Ltd.'s case (supra), law on this aspect was discussed in the following manner:

". . . From a reading of sub-section (1) of section, it is clear that the power of suo motu revision can be exercised by the Commissioner only if, on examination of the records of any proceedings under this Act, he considers that any order passed therein by the Income-tax Officer is 'erroneous insofar as it is prejudicial to the interests of the revenue'. It is not an arbitrary or unchartered power. It can be exercised only on fulfilment of the requirements laid down in sub-section (1). The consideration of the Commissioner as to whether an order is erroneous insofar as it is prejudicial to the interests of the revenue must be based on materials on the record of the proceedings called for by him. If there are no materials on record on the basis of which it can be said that the Commissioner acting in a reasonable manner could have come to such a conclusion, the very initiation of proceedings by him will be illegal and without jurisdiction. The Commissioner cannot initiate proceedings with a view to starting fishing and roving enquiries in matters or orders which are already concluded. Such action will be against the well-accepted policy of law that there must be a point of finality in all legal proceedings, that stale issues should not be reactivated beyond a particular stage and that lapse of time must induce repose in and set at rest judicial and quasi-judicial controversies as it must in other spheres of human activity. [See: Parashuram Pottery Works Co. Ltd. v. ITO [1977] 106 ITR 1 (SC) at page 10].



From the aforesaid definitions it is clear that an order cannot be termed as erroneous unless it is not in accordance with law. If an Income-tax Officer acting in accordance with law makes a certain assessment, the same cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately. This section does not visualise a case of substitution of the judgment of the Commissioner for that of the Income-tax Officer, who passed the order unless the decision is held to be erroneous. Cases may be visualised where the Income-tax Officer while making an assessment examines the accounts, makes enquiries, applies his mind to the facts and circumstances of the case and determines the income either by accepting the accounts or by making some estimate himself. The Commissioner, on perusal of the records, may be of the opinion that the estimate made by the officer concerned was on the lower side and left to the Commissioner he would have estimated the income at a figure higher than the one determined by the Income-tax Officer. That would not vest the Commissioner with power to re-examine the accounts and determine the income himself at a higher figure. It is because the Income-tax Officer has exercised the quasi-judicial power vested in him in accordance with law and arrived at conclusion and such a conclusion cannot be termed to be erroneous simply because the Commissioner does not feel satisfied with the conclusion. There must be some prima facie material on record to show that tax which was lawfully exigible has not been imposed or that by the application of the relevant statute on an incorrect or incomplete interpretation a lesser tax than what was just has been imposed.

We may now examine the facts of the present case in the light of the powers of the Commissioner set out above. The Income-tax Officer in this case had made enquiries in regard to the nature of the expenditure incurred by the assessee. The assessee had given detailed explanation on that regard by a letter in writing. All these are part of the record of the case. Evidently, the claim was allowed by the Income-tax Officer on being satisfied with the explanation of the assessee. Such decision of the Income-tax Officer cannot be held to be "erroneous" simply because in his order he did not make an elaborate discussion in that regard . . ." (pp. 113-117)

13. *When we examine the matter in the light of the aforesaid principle, we find that the Assessing Officer had called for explanation on this very items, from the assessee and the assessee had furnished his explanation vide letter dated 26-9-2002. This fact is even taken note of by the Commissioner himself in Para 3 of his order dated 3-11-2004. This order also reproduces the reply of the respondent in Para 3 of the order in the following manner :*

"The tools and dies have a very short life and can produce up to maximum 1 lakh permissible shorts and have to be replaced thereafter to retain the accuracy. Most of the parts manufactured are for the automobile industries which have to work on complete accuracy at high speed for a longer period. Since it is an ongoing procedure, a company had produced 10,75,000 sets whose selling rates is inclusive of the reimbursement of the dies cost. The purchase orders indicating the costing includes the reimbursement of dies cost are being produced before your honour. Since the sale rate includes the



reimbursement of dies cost and to have the matching effect the cost of the dies has been claimed as a revenue expenditure."

14. This clearly shows that the Assessing Officer had undertaken the exercise of examining as to whether the expenditure incurred by the assessee in the replacement of dyes and tools is to be treated as revenue expenditure or not. It appears that since the Assessing Officer was satisfied with the aforesaid explanation, he accepted the same. The CIT in his impugned order even accepts this in the following words :

"Assessing Officer accepted the explanation without raising any further questions, and as stated earlier, completed the assessment at the returned income."

15. Thus, even the Commissioner conceded the position that the Assessing Officer made the inquiries, elicited replies and thereafter passed the assessment order. The grievance of the Commissioner was that the Assessing Officer should have made further inquiries rather than accepting the explanation. Therefore, it cannot be said that it is a case of 'lack of inquiry'.

*16. Having put the records straight on this aspect, let us proceed further. Is it a case where the Commissioner has concluded that the opinion of the Assessing Officer was clearly erroneous and not warranted on the facts before him and, viz., the expenditure incurred was not the revenue expenditure but should have been treated as capital expenditure ? Obviously not. Even the Commissioner in his order, passed under section 263 of the Act, is not clear as to whether the expenditure can be treated as capital expenditure or it is revenue in nature. No doubt, in certain cases, it may not be possible to come to a definite finding and therefore, it is not necessary that in all cases the Commissioner is bound to express final view, as held by this Court in *Gee Vee Enterprises' case (supra)*. But, the least that was expected was to record a finding that order sought to be revised was erroneous and prejudicial to the interest of the revenue. [see : *Seshasayee Paper & Board Ltd.'s case (supra)*]. No basis for this is disclosed. In sum and substance, accounting practice of the assessee is questioned. However, that basis of the order vanishes in thin air when we find that this very accounting practice, followed for number of years, had the approval of the income-tax authorities. Interestingly, even for future assessment years, the same very accounting practice is accepted.*

17. It is in this context the question that assumes importance is as to whether powers could be exercised under section 263 of the Act when two views are possible and following observations of the Tribunal, in this backdrop, become relevant :

*"38. Still further, the Hon'ble Supreme Court in *Malabar Industrial Co. Ltd.'s case (supra)* has held that when two views are possible and the Assessing Officer has taken one of the possible view, then the order cannot be held to be prejudicial to the interest of the Revenue. Since the CIT could not come to a definite finding that the expenditure in question was a capital expenditure in the proceedings under section 263, in our opinion, the order of the Assessing Officer could not be held to be erroneous."*



18. Let us look into the matter from another angle. What was the material/information available with the Assessing Officer on the basis of which he allowed the expenditure as revenue? It was disclosed to him that the assessee is a manufacturer of car parts. In the manufacturing process, dyes are fitted in machines by which the car parts are manufactured. These dyes are thus the components of the machines. These dyes need constant replacement, as their life is not more than a year. The assessee had also explained that since these parts are manufactured for the automobile industry, which have to work on complete accuracy at high speed for a longer period, replacement of these parts at short intervals becomes imperative to retain accuracy. Because of these reasons, these tools and dyes have a very short span of life and it could produce maximum one lakh permissible shorts. Thereafter, they have to be replaced. With the replacement of such tools and dyes, which are the components of a machine, no new assets comes into existence, nor is their benefit of enduring nature. It does not even enhance the life of existing machine of which these tools and dyes are only parts. No production capacity of the existing machines is increased either. The Tribunal, in these circumstances, relied upon the judgment of Mysore Spun Concrete Pipe (P.) Ltd.'s case (supra) wherein Karnataka High Court held that the replacement of moulds was not in the nature of replacement of a capital machinery, but in the nature of replacement a part of the machinery which in turn was in the nature of maintenance of machinery installed in the factory. Such an expenditure was treated as revenue expenditure. With this position in law, it is clear that view taken by the Assessing Officer was one of the possible views and, therefore, the assessment order passed by the Assessing Officer could not be held to be prejudicial to the revenue. Such an order thus has rightly been set aside by the Tribunal.

19. When we consider the matter in the aforesaid perspective, it also becomes clear that the judgments under which Mr. Sanjeev Sabharwal, learned counsel for the revenue, had taken umbrage would not be applicable in the instant case and, therefore, would not come to his rescue. In Saravana Spg. Mills (P.) Ltd.'s case (supra) where the Supreme Court expounded the principle of "current repairs", clear finding recorded was that ring frames would constitute independent and separate machine capable of independent and specific functions, as is clear from the following observations :

"In our view, the Assessing Officer was right in holding that each machine including the Ring Frame was an independent and separate machine capable of independent and specific function and, therefore, the expenditure incurred for replacement of the new machine would not come within the meaning of the words "current repairs". In the present case it is not the case of the assessee that a part of the machine (out of 25 machines) needed repairs. The entire machine had been replaced. Therefore, the expenditure incurred by the assessee did not fall within the meaning of "current repairs" in section."

In the present case, finding is just the opposite, viz., dyes and tools are part of the machines. Replacing these dyes the purpose is to maintain the existing assets, viz., machine and not to bring a new asset. Moreover, case at hand is not a case of "repairs of machinery" which was the situation is in Saravana Spg. Mills (P.) Ltd.'s case (supra).



The present case proceeded on the controversy right from the order of Assessing Officer till ITAT as to whether this expenditure was revenue or capital in nature. Even before us, arguments rested on this aspect.

20. Likewise, whether the Commissioner should have recorded definite finding or not, may not be very relevant factor in the present case where on the facts of this case we have found that the opinion of the Assessing Officer in treating the expenditure as revenue expenditure was plausible and thus there was no material before the CIT to vary that opinion and ask for fresh inquiry.

21. Thus, from whatever the matter is to be looked into, the conclusion would be that the order of the Tribunal does not call for any interference as the question of law has rightly been decided. We, thus, answer this question in favour of the assessee and against the Revenue, consequence whereof this appeal is dismissed with cost.”

36. We note that on the similar facts, the Hon'ble Gujarat High Court in the case of Arvind Jewellers [259 ITR 0502] (Guj HC) in IT Ref. No.174 of 1989, held as follows:

“7. Coming to the facts of the present case, it is the finding of fact given by the Tribunal that the assessee has produced relevant material and offered explanation in pursuance of the notices issued under section 142(1) as well as section 143(2) and after considering those materials and explanation, the ITO has come to a definite conclusion. The Commissioner did not agree with the conclusion reached by the ITO. Section 263 does not empower him to take action on these facts to arrive at the conclusion that the order passed by the ITO is erroneous and prejudicial to the interest of the revenue. Since the material was there on record and the said material was considered by the ITO and a particular view was taken, the mere fact that different view can be taken, should not be the basis for an action under section 263 and it cannot be held to be justified.

8. In view of this and following the principles laid down by the Supreme Court in Malabar Industrial Co. Ltd.'s case (supra), we are of the view that having regard to the facts and circumstances of the case, the Tribunal was justified in setting aside the order passed by the Commissioner under section 263. We, therefore, answer both the questions in the affirmative, i.e., in favour of the assessee and against the revenue. The reference is, accordingly, disposed of with no order as to costs.”

37. Conclusion:

Thus, from the assessee's facts, it is abundantly clear that during the assessment stage, the Assessing Officer asked the assessee to furnish the details and documents which are placed in paper book. In response, the



assessee submitted reply which is also placed at paper book of the assessee. The assessee, during the assessment stage, has submitted books of accounts, balance sheets of two years, details of cash deposits and information to RBI. Depreciation on held for trading and available for sale, securities are claimed by the assessee, as per the provisions of the Act. Besides, various deductions and provisions, as we have narrated above are claimed by the assessee, as per the provisions of the Income tax Act 1961. Thus, all the documents, details and the explanations required by the Assessing Officer were submitted by the assessee. Just because the Assessing Officer does not bring these documents and details in his assessment order does not mean that assessing officer has not conducted proper enquiry during the assessment stage. In fact, assessing officer has applied his mind. The Learned Counsel for the assessee is right in his submission that one has to keep in mind the distinction between "lack of inquiry" and "inadequate inquiry". If there was any inquiry, even inadequate, that would not by itself, give occasion to the Commissioner to pass orders under section 263 of the Act, merely because he has different opinion in the matter. If an Income-tax Officer acting in accordance with law makes a certain assessment, the same cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately. Therefore, in the assessee`s case, it cannot be said that it is a case of 'lack of inquiry'. In view of the facts of the case and judicial pronouncements relied upon, it is well established that the impugned order passed u/s. 143(3) of the Act dated 07.11.2019, was passed by assessing officer, after calling for relevant information and after detailed examination of the same. The Assessing Officer has passed the assessment order after calling for details on the



various issues and after considering the reply and documents and after verification of the same and after due application of mind passed the assessment order, so it cannot be termed as erroneous and prejudicial to the interest of the revenue. So, the Ld. PCIT's finding fault, with the order of the Assessing Officer is erroneous as well as prejudicial to the interest of revenue, on account of lack of inquiry, has to fail. Based on these facts and circumstances, we quash the order dated 24.01.2022 passed by the Id PCIT under section 263 of the Act.

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

Order pronounced in the open court on 30-09-2025.

Sd/-
(DINESH MOHAN SINHA)
JUDICIAL MEMBER

Rajkot

दिनांक/ Date: 30/09/2025

Copy of the Order forwarded to

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

Sd/-
(Dr. A. L. SAINI)
ACCOUNTANT MEMBER

By Order

Assistant Registrar/Sr. PS/PS
ITAT, Rajkot