Power of Revision of orders under Sections 263 & 264 of the Income Tax Act 1961, at NALSAR Law University

A brief background

- Income Tax Act, one the most complex pieces of legislation which befuddled even Einstein (All laws except Constitution)

- Alphabet “a” comes up for interpretation by Courts

- Court, Tribunal benches, & CsIT (A), AAR, DRP pronounce judgments / orders by the scores on a daily basis

- Extremely confounding to keep track of the law so evolving,

- Tax-payers grapple endlessly with tax determination

- Ante-dated legislation & arbitrary discretion (run with the hare & hunt with the hound)

- **Power of revision of an assessment order in**
  - Indian Income Tax Act 1922, u/s 33B
  - Income Tax Act 1961, u/s 263

- Appeal not possible by dept. against AO's order

- **Terms used in Section 264**
  - Order, other than an order to which section 263 applies
  - either of his own motion or on an application by the assessee for revision (note that AO cannot make such application)
  - call for the record of any proceeding
  - make such inquiry or cause such inquiry to be made
  - may pass such order thereon, not being an order prejudicial to the assessee

Explanation

Explanation 1.—An order by PCIT declining to interfere shall, be deemed not to be an order prejudicial to the assessee.

Section 264

- a dead letter, to the extent of suo motu revision
- meant to correct erroneous order causing prejudice to assessee, hence a benevolent provision
- as appeal is available, PCsIT hardly invoke section 264 revision
- Dead end reached upon section 264 order
- Only remedy is writ before the High Court

- **Terms used in Section 263**
  - may call for and examine the record of any proceeding
  - if he considers that
  - is erroneous
  - in so far as it is prejudicial to the interests of revenue
  - opportunity of being heard
  - after making or causing to be made such inquiry
  - pass such order as the circumstances of the case justify
  - including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment

Practice adopted to invoke section 263 revision

- Audit objections
- Proposal from the AO, constitutionally unlawful
- Thru JC, CIT approves revision
- This is power of review of order by AO, not available even to Tribunals. Review is available only to constitutional courts

Explanation 1 to Section 263(1)

Clause (a), orders includes

- the directions issued by JCIT under section 144A
- an order made by JCIT in exercise of the powers of an AO

Clause (b)

- record shall include all records relating to any proceeding under this Act available at the time of examination by PCIT

Clause (c)

- Where order had been “the subject matter of any appeal” revision to extend to only such matters as had not been considered and decided in such appeal

Explanation 2 to Section 263(1)

- **order passed by AO shall be deemed to be erroneous, if, in the opinion of PCIT:**

Clause (b),

- order is passed allowing any relief without inquiring into the claim

Clause (c)

- order has not been made in accordance with any order, direction or instruction issued by CBDT u/s 119

Clause (d)

- order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person. (Tribunal is absent here and also in Litigation Management Scheme)

- **Explanation 2 to Section 263(1)**
  - order passed by AO **shall be deemed to be erroneous, if, in the opinion of PCIT:**

Clause (a),

- **the order is passed without making inquiries or verification which should have been made**

Sub-section (2) to section 263

No order shall be made under sub-section (1) after expiry of two years from the end of the financial year in which the order sought to be revised was passed

Ejusdem Generis

- it means that birds of a feather flock together.
- the clauses (b), (c) & (d) lay a parameter for PCIT
- Clause (a), the odd man out.

Discretion: the lesser the better

- That system of law is best which confides as little as possible to the discretion of a judge; that judge the best who trusts as little as possible to himself (“optima est lex quae minimum relinquit arbitrio judicis, optimus judex qui minimum sibi)

- **Hon’ble PM,** on dedicating faceless assessment scheme, said: ***“Policy driven governance…….when policy is clear, the grey areas are minimum, ……….there is a reduction in the element of discretion in government decision-making”***
- Reduce litigation (plank of this government) Ravi Shankar Prasad: “Judges must define contours of manifest arbitrariness”, “if manifestly arbitrary as a ground is used to nullify legislation then it is important to define the contours in judicially manageable standards so that lawmakers can know it.”

- The PCIT is a "participatory functionary", of the nature enunciated by the SC in the case of K Veeraswami **in the administration of the law and his adjutants.**

- In State of Uttarakhand v Tilak Seth, the High Court observed that: "The court cannot be a silent spectator like an umpire in a cricket match, who is assigned the task of raising his finger and pointing to the faults in the game. A judge is an active participant in a trial proceeding". No different shall be the role of PCIT.

- V R Krishna Iyer "vague & wandering jurisdiction with uncertain boundaries"

- Implied Limitation to be read on clause (a) (Nani Palkhivala)

- Constitutional duty to follow the law, Vegetable Products (SC)

- **Section vs Explanation vs Proviso vs Rules**
  - Section & Proviso legislative creature
  - Explanation legislative creature
  - Rules, Circulars, guidelines etc executive creature

- **Purpose of an Explanation**
  - S. Sundaram Pillai, etc. v. V. R. Pattabiraman
  - Keshavji Ravji & Co v CIT
  - Hiralal Ratanlal v State of UP
  - Burmah Shell Oil Ltd v CTO

- **Section 263 (Requirements for revision)**
  - Order erroneous insofar as it is prejudicial to the interests of the revenue
  - Erroneous & prejudicial to interests of revenue not defined

- Clause (a) of Explanation 2, to sub-section (1) of section 263, inserted wef 1st June 2015

- Power of revision for about 100 yrs before insertion of Explanation 2, **YET No Explanatory Memorandum adduced. Heydon's mischief rule**

S. Sundaram Pillai, etc. v. V. R. Pattabiraman

- "It is now well settled that an *Explanation* added to a statutory provision is not a substantive provision in any sense of the term but as the plain meaning of the word itself shows it is merely meant to explain or clarify certain ambiguities which may have crept in the statutory provision.“

Keshavji Ravji & Co v CIT

- As long as there is no ambiguity in the statutory language resort to any interpretative process to unfold the legislative intent become impermissible. The supposed intention of the legislature cannot then be appealed to whittle down the statutory language which is otherwise unambiguous…….An 'Explanation', generally speaking, is intended to explain the meaning of certain phrases and expressions contained in a statutory provision

Hiralal Ratanlal v State of UP

- "……….,it is clear that if on a true reading of an Explanation it appears that it has widened the scope of the main section, effect be given to legislative intent notwithstanding the fact that the Legislature named that provision as an Explanation."**In all these matters courts have to find out the true intention of the Legislature**.

Burmah Shell Oil Ltd v CTO (no role reversal- Hidyatullah J)

- "Now, the *Explanation* must be interpreted according to its own tenor, and it is meant to explain cl.(1)(*a*)of the Article and not vice versa. **It is an error to explain the *Explanation* with the aid of the Article, because this reverses their roles."**

- **Order passed *“without making inquiries or verification, which should have been made”*, deemed erroneous.**
  - unbridled, unstructured, undefined, unprincipled & arbitrary power enshrined in clause (a),
  - without furnishing the PCIT policy or principle to deem an order erroneous,
  - Supreme Court, in Dwarka Prasad Laxmi Narain & Dhirendra Kumar breaches equality enshrined in Article 14 of the Constitution.

- **“which should have been made”**
  - Compulsion without any guideline or policy, “Should” to be read as “could”
  - shall mean that ***“litigation would have no end, except when legal ingenuity is exhausted”,*** as was held by Lord Shaw. Radhasoami Satsang (SC)

- **To save clause (a) from attack of Article 14**
  - furnish policy or principle to the PCIT; or
  - instruct CBDT/PCIT to enlist inquiries or verification that should be made by the AO at the stage of assessment, at least in relation to intricate issues.
  - **this would obviate the drift of clause (a) into a *lawless law***

In a lighter vein (possible defences of the PCIT)

- Court is not a cathedral, but a casino where the throw of a dice decides the outcome, (K K Venugopal reference)
- C K Dapthary, “gambling” is what is seen day in & day out in the courts **(PCIT can take refuge under this premise, if courts can gamble, equally can the PCIT also)**
- Donald Trump, “I’m the only one that matters”

- **PCIT to furnish inquiries to be made at assessment**
  - He is an administrative head,
  - Authority to remove error includes responsibility to prevent passing such orders in the first place,
  - Even Section 144A orders are liable to revision,
  - Conducts like a knight-errant roaming at will in pursuit of his own ideal of beauty or of goodness.

- **Performance of PCIT**
  - 85% of the appeals filed by the department reversed

- Compare section 142(2) inquiry with section 263
  - Such inquiry as he considers necessary s 142(2)

- The department has multiple defences in respect of the entire order, in section 246A appeal the entire order is open; audit objection; section 154 rectification, section 132 search & survey, section 142 (2A) special audit, section 148 income escaping assessment, departmental informers, all of which can be simultaneously initiated in respect of the same order. Also penalty & prosecution.

- Yet 263 Revision — **Harmonious construction needed**

- **Malabar Industrial Co Ltd v CIT (favour of dept)**
  - sum received towards damages was shown by the assessee in his return as "compensation & damages for loss of agricultural income".
  - The AO accepted the said claim of the assessee, without even taking the resolution of Board of directors on record.
  - He did not make an enquiry in connection with this claim.
  - There was in fact, no material to support the contention of assessee that the sum received represented compensation for loss of agricultural income.
  - CIT invoked revision, held to be valid by SC

  - **Land Mark decision in defining an erroneous order:**

    incorrect assumption of facts; incorrect application of law;

    denial of principles of natural justice; no application of mind

Justice Antonin Scalia (A lion of the law)

- Discuss US Supreme Court vs Indian Supreme Court,
- Composition of benches of Indian Supreme Court
- Assertion of Attorney General K K Venugopal

- "to allow the **policy question** of same-sex marriage to be considered and resolved by a select, patrician, highly unrepresentative panel of nine, **is to violate a principle even more fundamental** than no taxation without representation: no social transformation without representation."

Justice Antonin Scalia (A lion of the law)

- Dedicated to text of the law. His interpretations meant that: “If the intendment is not in the words used it is nowhere else”
- Justice Antonin Scalia noted, its members are by many measures remarkably similar, giving the court the quality of a private club.
- SCOTUS has descended from the disciplined legal reasoning of John Marshall and Joseph Story to the **mystical aphorisms of the fortune cookie.**

- **Justice Antonin Scalia (A lion of the law)**
  - leaving a policy matter to PCIT to deem an order by AO erroneous, unjustified.
  - Legislature and not judiciary to address policy matters

- **DRP a collegium of 3 PCsIT order**
  - PCIT a statutory creature
  - DRP a CBDT creature
  - Would he be able to muster to gumption to reverse DRP order?
  - Devas Multi-media (Karnataka HC) There is no bar for Principal Commissioner to invoke section 263 in order to examine final assessment order passed by Assessing Officer pursuant to DRP decision

- **Could have possibly inspired insertion of clause (a)**
  - Rampyari devi Saraogi
  - Taradevi Aggarwal
  - Kalawati devi Harlalka,   all Supreme Court judgments

  - All these cases had similar facts.
  - Orders were passed by the AOs without making any enquiry or verification (ie no inquiries made)
  - “Absence of enquiry or verification” is not the same as “inquiries & verification which should have been made”

- No explanatory memorandum furnished on insertion of clause (a)

Taradevi Aggarwal

- Assessee argued that, where an assessee has filed a return of income voluntarily and has been assessed to tax in respect of that income, it cannot be said that the assessment cannot be made; and when such an assessment is made, it cannot be said that it was prejudicial to the interests of the revenue.
- SC held that: "Even where an income has not been earned and is not assessable, merely because the assessee wants it to be assessed in his or her hands in order to assist someone else who would have been assessed to a larger amount, an assessment so made can certainly be erroneous and prejudicial to the interests of the revenue."
- SC held that: "PCIT may initiate proceedings for assessment under the provisions of the Act against some other assessee who according to him is liable for the income thereof."

Senairam Doongarmal Agency P Ltd (Gauhati HC) (1964)

“concluded that when classification that a particular provision should apply to a particular person is not made, but it is **left to discretion, without guiding principles or policies** to exercise discretion; delegation of power is arbitrary & permits discrimination in respect of persons similarly situate.”

“Hence the **law & executive action** shall both be struck down as violative of article 14 of the Constitution. In arriving at this judgment the honourable Assam High Court referred to the judgments of the honourable Supreme Court in cases of Dwarka Prasad v. State of Uttar Pradesh Dhirendra Kumar v. Supdt. And Remembrancer of Legal Affairs to the Government of West Bengal”

Venkata Krishna Rice Mills (Madras HC)

Prejudicial to the interests of the revenue

“the expression should not be considered in a pettifogging way and ought to be granted a dignified construction.”

“The revenue is equitable to the crown. It said that the expression prejudicial to the interests of the revenue must be regarded as involving a **beginning of acts or orders which are subversive of the administration of revenue.**”

“It said that there must be some grievous error which might set a bad trend, which the Commissioner thinks might prejudice the interests of the revenue administration”

- **Compare section 264 with section 263**
  - both powers exercisable *suo motu*
  - Reducing litigation is an aspect of National Litigation Policy.“**The Government must cease to be a compulsive litigant. The philosophy that matters should be left to the courts for ultimate decision has to be discarded. The easy approach, Let the court decide must be eschewed and condemned.”**
  - orders termed erroneous by PCIT & not appealed by assessee be also revised u/ 263, so that the prejudice to the interests of revenue is obviated, by applying Venkata Krishna Rice Mills

Administrator of Estate of Lt. Edulji Framroze Dinshaw v. CIT

- Application of mind by AO ousts Revision jurisdiction - corollary to Malabar,

- If under provision of section 4 an amount does not bear character of income and, hence, is not chargeable to tax, then same cannot be converted into an 'income' only because payer of sum deducts tax on same under misconception of law.

- AO had applied her mind, PCIT was mechanical, hence 263 held invalid

Sidhi Vinayak Metcon Ltd.

- The Jharkhand High Court said that PCIT to **conduct orientation or induction courses** for the AOs held that the AO should be made to understand that when there is a receipt of an amount, he needs to issue notice to the drawer of cheque. It states that the mistakes are committed by the AO "either deliberately" or due to "induced ignorance".

Plausible view by AO ousts Revision jurisdiction (Kesoram Inds – Calcutta HC)

- “Where as regards initiation of revisional proceedings, once it is seen that a plausible or reasonable view has been taken by Tribunal upon a fair discussion of matter, Court in exercise of appellate jurisdiction would not supplant its view in place of Tribunal's unless error is apparent and palpable.”

Delegated legislation – exceeds powers of constitutional courts Vasantlal Maganbhai v. State of Bombay

- Supreme Court pointed out that the legislature could not delegate its essential legislative function in any case.

- **AO cannot be directed to express satisfaction for levy of penalty** CIT v Chennai Metro Rail Ltd

Preponderance of probability -- P Suhrith & Gautam Bhatia

- "It means that the court weighs the available evidence and determines which of the competing claims is more likely to be true."

- **PCIT to approach with an open & not empty mind; like judges,**

Can restrictions be imposed on power of PCIT, without backing of law ??

- This is exactly the question which was posed by Attorney General of India KK Venugopal to the constitution bench of SC which heard case that Citizen's Fundamental rights to lead a dignified life, requires public functionaries' right to free speech be curtailed, with reasonable restrictions on free speech

Error in favour of Revenue, is pre-ordained – Impartiality violated Hardayal Singh (CCIT)

- Impartiality part of basic structure doctrine of Constitution.

PCIT conduct displays "if we can never be right, it is better that we should, from time to time change our way of being wrong", T S Eliot

- Legal scholar Aharon Barak: **"Strike the right balance between certainty and experimentation, between stability and change, and between logic and emotion.“**

- **Elimination the best method – informed speculation ……….**थोथा देई उड़ाये. Medical science approach

- **Revision vs Review function of constitutional courts**

- **AO to be watchdog & not blood hound, in assessment**

- PCIT v Maruti Suzuki India Ltd (Supreme Court) **Certainty**

  There is a value which the court must abide by in promoting the interest of certainty in tax litigation. Not doing so will only result in uncertainty and displacement of settled expectations. There is a significant value which must attach to observing the requirement of consistency and certainty. Individual affairs are conducted and business decisions are made in the expectation of consistency, uniformity and certainty. To detract from those principles is neither expedient nor desirable.”

- **Lord Macaulay’s quote (**Uniformity, Diversity, Certainty)

Bombay HC in Humayun Suleman Merchant v CCIT

- held that while construing an all India statute like the Income-tax Act, we would not easily depart from a view taken by another High Court on an issue arising for our consideration on consideration of certainty and consistency in law. It is equally true that the Courts would also like to know the stand of the revenue in different jurisdictions on same subject as the Court in the following citations have been very emphatic in stating that it is not open for the Revenue to take one stand in the case of some assessees and to challenge the correctness of the same in case of other assesses:

a) *Union of India* v. *Kaumudini Narayan Dalal* [2001] 117 Taxman 375 (SC).

b) *CIT* v. *Narendra Doshi* [2002] 122 Taxman 717 (SC)

c) C*IT* v. *Shivsagar Estate* [2002] 124 Taxman 606 (SC)

d) *Berger Paints India Ltd*. v. *CIT* [2004] 135 Taxman 586

- **Dr B R Ambedkar's quip about Constitution**
  - However good the constitution, if people enforcing are not…
  - "The Chief Justice is a man with all the failings, all the sentiments & all the prejudices which, we as common people have"
  - Hence it is desirable that there is a Collegium of Commissioners to invoke section 263
- **Directive Principles (Upendra Baxi)**
  - A paramount duty is cast on the executives and also the legislature, to implement the directive principles. He said that the entire structure of administrative law requires that those who exercise public power ought not to be arbitrary in their conduct & actions

Orders passed by JCIT/ Addln CIT

- At times JCs also function as AO, whom does he go to for direction, inherent anomaly.

- **Authorities to engage themselves, rather with assessee in court—No bar to issue directions to JCIT**

- The phrase “without making inquiries or verification which should have been made" invites subjective and greatly differing readings and application which is incapable of being “certain, final and even-handed,” That’s why, “the phrase violates the demand of Article 14 of equal treatment & non-arbitrariness.”

- Tax laws must pass the test of article 14 and extent of reasonability of any taxation statute lies in the efficiency to achieve objects sought to be achieved by statute. ACC v Govt of Andhra Pradesh 2006 taxmann.com 1849 SC.

- **Guidelines to AO does not constrain the Revenue**
  - As there are mere guidelines – CBDT creatures & not binding law, but help in reducing litigation

- **Concept of assistance to AO, not alien to income tax**
  - section 142 (2A) – Special Audit
  - Valuation of assets

- **Opinion/guidelines no secret to be guarded**

- **Inquiries or verification only in accordance with those recommended by the judiciary**

- **Even Government desires reducing litigation**
  - Vivad se Vishwas Scheme
  - Other plethora of schemes by this government
  - Increasing the monetary limits to file appeals by dept.
  - Repeal of retrospective amendment to Section 9 (Vodafone & Cairn Energy judgment of ICJ). Uncertainty more dreadful than the most draconian law; frightens both government & assesses
  - Government a very weak & inefficient litigant, wants to reduce litigation, increase in tax limits for appeals, Vivad se Vishwas Scheme & other schemes

- Department to keep a record of questions of law. CIT v TCL Holding (P) Ltd (Bombay HC)
  - this is effort to reduce litigation even by court

Justice is an overarching principle, an underlying fundamental……. (CJI Ranjan Gogoi)

- "And, here, I would like to clarify that by justice, I am not implying only the juridical connotation of the word which is the administration of justice by the courts of law -- although it is just as imperative -- but justice is something that an overarching principle, an underlying fundamental, the spirit, an order so to say. Which is why I say prodigious“.

- Bombay HC (in Supreme Industries), magnified and explained SC Grindlays Bank judgment.

Bombay HC (in Supreme Industries)

- “It is a settled position in law that every authority exercising quasi judicial powers has inherent/incidental power in discharging of its functions **to ensure that justice is done between parties i.e. no prejudice is caused to any of the parties.**”

Experiments in rationalising & systematising law– courts not laboratories

- “the colonial environment was the perfect field for experiments in rationalising & systematising the law. The colonies were passive laboratories"

Legal aid be furnished to AO/assessee, towards inquiries to be conducted

- Article 22(1) gives the fundamental right to every person not to be denied the right to be defended by a legal practitioner of his or her choice.

- Article 39A, Part of the Directive Principles of State Policy, states that equal opportunity to secure justice must not be denied to any citizen by reason of economic **or other disabilities and provides for free legal aid.**

- **PCIT should furnish the inquiries that are necessary, as a form or free legal aid**

Read down the provision – in face of constitutional challenge

- Plethora of judgments (proviso to section 2(15))
- Section 145 (2), ICDS not to override judicial precedents

Judicial experience, insight & wisdom help correct even judges

- Justice Y V Chandrachud & Justice P N Bhagwati both publicly regretted the judgement pronounced by them in case of ADM Jabalpur.
- Justice Kurian Joseph on repeal of NJAC

Casus omissus

- “a situation omitted from or not provided for by statute or regulation and therefore governed by the common law.”
- **Only the SC can fill in the vacuum** prevalent in law to ensure that the justice is done.
- The lower judiciary & even the quasi-judicial authorities to put up such a finding, necessitating the Supreme Court to intervene in this respect.

- Law is not Discretion, it sets minimum standards of fairness - Justice S H Kapadia

- "Interest Republica ut sit finis Litiun," means that "it is in the interest of the state that there should be an end to litigation"

Assessee has a right to avoid litigation

The assessees have a right to avoid litigation and also to have a fair treatment at the hands of the executives who implement the legislation. "One right cannot be taken away at the behest of another."

AO of domestic taxation, poor cousin of AO in Intln Taxation

- There exist abundant provisions to refer the matter to Transfer Pricing Officer (TPO) to determine the correct valuation,

- For proper administration of the Income-tax Act, the Board has decided that the AO shall henceforth make a reference to the TPO **only under the circumstances laid out in the Instruction.**

Orders u/s 144A direction, vulnerable to Revision

- Power of Addln CIT to issue directions,
- Orders passed in pursuance of s 144A, also liable to revision

- Just because the assessee has a right of appeal against the order of revision of the PCIT, does not mean that his right to have a fair, just & legally valid order at the stage of assessment itself can be taken away.

- "The potential for discrimination is sufficient to breach the principle of equality before the law, enshrined in article 14…….” **based on Jamaican SC ruling.** The dissenting view of Justice Chandrachud was upheld by the Jamaican Supreme Court, in striking down Jamaica’s National Identification and Registration Act, which would have allowed collection of biometric information from all citizens to be centrally stored.

Basic Structure of the Constitution

- Rule of law
- Due process of law (**Discuss Article 21, Justice Fazl Ali's dissent**)
- Independence
- Impartiality

- Rule of law is the antithesis of arbitrariness. Justice H R Khanna

- It is dangerous to be right, when your government is wrong. Justice Napolitano.

- **T N Arvinda Reddy (SC)**
  - Justice V R Krishna Iyer held that: "The signification of a word of plural semantic shades may, in a given context, depend on the pressure of the context or other indicia. Absent such compelling mutation of sense, the speech of the lay is also the language of the law".
  - Yet he admitted to one nostalgically remembering, in the face of suffocating scholarship arriving in the court, the escapist verse: **“Where ignorance is blist; Tis is folly to be wise. Amen!".**
  - This is exactly the state of mind of this speaker.