REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 6126 OF 2021
(@ SLP (C) NO. 13380 OF 2018)

The Commissioner of Income Tax 7 …Appellant(s)

Versus

M/s. Paville Projects Pvt. Ltd. …Respondent(s)

J U D G M E N T

M.R. SHAH, J.

1. Feeling aggrieved and dissatisfied with the impugned judgment and order dated 18.09.2017 passed by the High Court of Judicature, at Bombay in ITA No.78 of 2015 by which the High Court has dismissed the said appeal preferred by the Revenue, the Revenue has preferred the present Appeal.

2. The relevant assessment order concerning the present appeal is Assessment Year 2007-08.

3. The respondent assessee was engaged in manufacture and export of garments, shoes etc. It filed its income tax return for the AY 2007-08 wherein it showed sale of the property / building "Paville House" for an amount of Rs.33 Crores. That, the building "Paville House" was constructed by the assessee on the piece of land which was purchased in the year 1972. The said house of the company was duly reflected in the balance sheet of the company.

3.1 It appears that there had been litigation between shareholders of the Company being family members. Litigations in the Company Law Board and the High Court culminated in arbitration. In the arbitration proceedings, an interim award was passed whereby an amicable settlement termed as "family settlement" was recorded between the parties. As per the interim award, three shareholders viz. (1) Asha, (2) Nandita and (3) Nikhil were paid Rs.10.35 Crores each. According to the assessee,

"Paville House" was sold to discharge encumbrances from the sale proceeds to pay off the shareholders and therefore, the said discharge of encumbrances was "cost of improvement". As observed hereinabove, "Paville House" was sold for an amount of Rs.33 Crores. The assessee showed gains arising therefrom amounting to Rs.1,21,16,695/- as "long term capital gains" in the computation of their income for AY 2007-08. The working computation of capital gains was accepted by the AO, whereby the cost of removing encumbrances claimed (Rs.10.33 Crores paid to three shareholders pursuant to the interim award) was taken as "cost of improvement" and the deduction was claimed to remove encumbrances on computation of capital gains. On the balance amount capital gain tax was offered and paid. The assessment was completed on 15.12.2019 by the AO under Section 143(3) of the Income Tax Act (for short "IT Act") accepting the "long term capital gains" as per sheet attached in computation of income.

3.2 However, a notice dated 24.10.2011 was issued by the Commissioner of Income Tax-7 under Section

263 of the IT Act to show cause as to why the assessment order should not be set aside under Section 263 of the IT Act. The Commissioner vide its order dated 24.11.2011 held that the assessment order passed under Section 143(3) of the IT Act was erroneous and prejudicial to the interest of the revenue on the issue relating to deduction of Rs.31.05 Crores claimed by the assessee as cost of improvement while computing long term capital gains. The claim of the assessee that the said payment was made by them towards settlement of litigation, which according to the assessee amounted to discharge of encumbrances and required to be considered as cost of improvement, was not accepted by the Commissioner as according to him it did not fall under the definition of "cost of improvement" contained in Section 55(1)(b) of the IT Act. According to the Commissioner, the expenses claimed by the assessee neither constituted expenditure that is capital in nature nor resulted in any additions or alterations that provide an enhanced value of an enduring nature to the capital asset. The Commissioner also held that the payment as contended, was not made by the assessee to remove encumbrances.

3.3 The Commissioner also held that provisions of sections 50A and 55(1)(b) of the IT Act have not been complied with and the assessment order is not

framed in consonance with the provisions of the IT Act and thus the assessment order was erroneous and prejudicial to the interest of the revenue. Consequently, the Commissioner set aside the assessment order passed by the AO with a direction to the AO to recompute the capital gains of the assessee in consonance with the provisions of the IT Act as discussed in the order.

3.4 The assessee approached the Income Tax Appellate Tribunal (for short "ITAT") by way of filing ITA No.16/MUM/2012 against the order passed by the Commissioner, passed under Section 263 of the IT Act. The ITAT relying upon the decision of this Court in the case of **Malabar Industrial Co. Ltd. Vs. CIT [(2000) 2 SCC 718 : (2000) 243 ITR 83 (SC)]** concluded that the Commissioner wrongly invoked the jurisdiction under Section 263 of the IT Act. The ITAT also observed that there was no error on facts declared. The ITAT held that every loss of revenue as a consequence of AO's order cannot be treated as prejudicial to the interest of the revenue, when two views were possible and AO took a view which CIT did not agree with. The ITAT also upheld the allowability of the assessee's claim of deduction of payment made to the shareholders relying upon the decision of the Bombay High Court in **CIT Vs. Smt. Shakuntala Kantilal [(1991) 190 ITR 56 (Bombay)]**. The ITAT relying on the Tribunal's order

(Bombay Bench) in **Chemosyn Ltd. Vs. ACIT [2012 (25) Taxxman.com 325 (Bombay)]** held that the CIT's observation of expenditure incurred for payment of shareholders not being deductible as incorrect.

3.5 The Department's appeal against the ITAT's order has been dismissed by the High Court by the impugned judgment and order wherein the High Court has confirmed the ITAT's findings. The High Court agreed with the findings recorded by the ITAT that the claim for deduction of Rs.31.05 Crores was for ending the litigation and the litigation ended only when the building was sold and the payment was made as per the direction of the Company Law Board as well as the interim arbitral award and therefore, the same was deductible under Section 55(1)(b) of the IT Act, as allowed by the AO.

3.6 Feeling aggrieved and dissatisfied with the impugned judgment and order passed by the High Court dismissing the appeal preferred by the Revenue and confirming the order passed by the ITAT by which the ITAT set aside the order passed by the Commissioner passed under Section 263 of the IT Act, the Revenue has filed the present appeal.

4. Shri Balbir Singh, learned ASG appearing on behalf of the Revenue has vehemently submitted that the High Court has materially erred in dismissing the appeal preferred by the Revenue and confirming the order passed by the ITAT by which the ITAT set aside the order passed by the Commissioner passed in exercise of powers under Section 263 of the IT Act.

4.1 It is submitted that the High Court has not at all appreciated the fact that the view taken by the AO in allowing the expenses of Rs.31.05 Crores while computing the capital gain from sale of the land was erroneous and not as per the law as payments made to shareholders are neither expenses nor the said payments have any relation to the asset under consideration. It is further submitted that the High Court has also not properly appreciated that the claim of the assessee that amount of Rs.31.05 Crores paid by it in lieu of settlement of litigation would amount to discharge of encumbrances and therefore, requires to be considered as cost of improvement on the said property is bad in law. It is submitted that payment of Rs.31.05 Crores paid to the shareholders did not lead to acquisition of any interest in the asset already acquired by the assessee. It is submitted that the rights already enjoyed by the assessee on the said property were

absolute. It is submitted that therefore the assessment order passed by the AO was erroneous, bad in law and prejudicial to the interest of the revenue and therefore, the same was rightly set aside by the Commissioner under Section 263 of the IT Act, which ought not to have been set aside by the ITAT.

4.2 It is further submitted that Commissioner rightly observed that the assessee company was the clear owner of the property and that there was no encumbrance preventing the sale of the said property. The family dispute among the three shareholders brother and two sisters, which resulted in a settlement by way of arbitration award, as per which the three shareholders became entitled to Rs.10.35 Crores each for transfer of shares as well as relinquishment of any right or claim to additional shares in the company had nothing to do with the improvement in the property. It is submitted that shareholders only concern was that the sale proceeds should first be utilized for making payments to them as per the arbitration award. It is submitted that therefore both, the Tribunal as well as the High Court have erred in concluding that the payment of Rs.10.35 Crores were admissible as deduction.

4.3 It is submitted that both, the ITAT as well as the High Court have committed error in setting aside the

order of the Commissioner on the basis of the ratio laid down in the cases of **Chemosyn Ltd. (supra)** and **Smt. Shakuntala Kantilal (supra)**, without appreciating that the facts of the present case are not identical to the facts involved in the relied upon judgments.

4.4 It is further submitted that even otherwise as part of the asset sold was used in the business of the assessee and hence, capital gains on that part of the asset sold is required to be taxed as per the provisions of Section 50A of the IT Act and hence, the entire order of Commissioner of Income Tax could not have been set aside.

Making above submissions it is requested to allow the present Appeal.

5. Present appeal is vehemently opposed by Shri Firoze Andhyarujina, learned Senior Advocate appearing on behalf of the assessee.

5.1 It is vehemently submitted by learned Counsel appearing on behalf of the assessee that in the facts and circumstances of the case, no error has been committed by the High Court in upholding the order passed by the ITAT setting aside the order passed by the Commissioner holding that the Commissioner wrongly exercised the revisional powers under Section 263 of the IT Act.

5.2 It is submitted that the High Court relying upon the law laid down by this Court in the case of **Malabar Industrial Co. Ltd. (supra)** has specifically held that the Appellate Tribunal rightly considered the orders of assessment and the order of the Commissioner and thereafter concluded that Commissioner wrongly assumed the power under Section 263 of the IT Act.

5.3 It is submitted that the order passed by the AO was a well-reasoned order passed after scrutiny of the return of income and the view taken by the AO was plausible view and therefore, the assessment order cannot be considered to be erroneous and prejudicial to the interest of the Revenue, which was required to be taken in revision by the Commissioner under Section 263 of the IT Act.

5.4 It is submitted that view taken by the AO on allowability of the claim of deduction as cost of improvement was duly supported by a judicial decision of the Bombay High Court in the case of **Smt. Shakuntala Kantilal (supra)**. It is submitted that as such the Commissioner failed to appreciate that unless the shareholders' claims were satisfied there would not have been a sale of the entire portion of the property. It was only to derive the benefit by sale of the encumbrance asset that the

parties resorted to settlement through arbitration. The dispute being settled, payments having been made, the AO committed no error in allowing the claim of deduction as cost of improvement.

5.5 It is further submitted by learned Counsel appearing on behalf of the assessee that in the case of **Malabar Industrial Co. Ltd. (supra)**, this Court has held that if the order is erroneous but is not prejudicial to the interest of the Revenue, the Commissioner cannot exercise the revisional jurisdiction under Section 263 of the IT Act. It is submitted that it is further observed and held that every loss of revenue as a consequence of an order of AO cannot be treated as prejudicial to the interest of revenue. As observed and held, if the AO has adopted one of the courses permissible in law and it has resulted in loss of revenue or where two views are possible and the AO has taken one view with which CIT does not agree, it cannot be treated as erroneous order prejudicial to the interest of revenue.

5.6 It is further submitted by the learned Counsel appearing on behalf of the assessee on encumbrances that in the present case there was arbitration proceeding between the shareholders of the company whereof all the litigations came to an end and an interim arbitration award was entered

into whereby the entire matter was amicably settled and the settlement which is “Family Settlement” partook the character of an interim award and later on achieved its finality on fulfillment of commitment. It is submitted that in the present case the shareholders have been paid Rs.10.35 Crores each. It is submitted that the said payment was made by the Company for (i) smooth running and functioning of the business; (ii) to put an end to litigation amongst the shareholders; (iii) to preserve the assets of the company; (iv) to ensure that there is continuity and safeguard and, amicable settlement amongst the brother and two sisters, who are the shareholders of the company and (v) to remove encumbrances on the property. It is submitted that therefore the payment was necessitated and sanctioned and approved as per the orders of the High Court and the arbitration award as well as shareholders themselves. It is submitted that infact in the interim award there was a specific clause which entitles the Company to sell the assets to discharge the liabilities. It is submitted that as per the arbitration award, the claims have to be paid off of the shareholders. This was an encumbrance which has to be discharged pursuant to the orders of the Court and arbitration award. “Paville House” was therefore required to be sold to discharge the encumbrances and from sale proceeds to pay off the shareholders and therefore, the discharge of

encumbrances was the cost improvement. It is submitted that therefore the amount paid to the shareholders which was rightly held to be to remove encumbrance, was rightly held to be deduction as claimed to remove encumbrance on computation of capital gains.

5.7 It is submitted that therefore the Commissioner wrongly assumed the jurisdiction under Section 263 of the IT Act on the ground that the order passed by the AO was an erroneous and prejudicial to the interest of the Revenue.

Making above submissions and relying upon the decision of this Court in the case of **Malabar Industrial Co. Ltd. (supra)**, it is prayed to dismiss the present appeal.

6. Heard.

7. In the present case, the Commissioner, in exercise of the powers under Section 263 of the Income Tax Act and in exercise of the revisional jurisdiction, set aside the assessment order by specifically observing that the assessment order was erroneous as well as prejudicial to the interest of the Revenue. However, the High Court by the impugned judgment and order has set aside the order passed by the Commissioner by observing that the Commissioner wrongly invoked the powers under Section 263 of the Act.

7.1 Learned counsel appearing on behalf of the assessee has heavily relied upon the decision of this Court in the case of **Malabar Industrial Co. Ltd. (supra)**. It is true that in the said decision and on interpretation of Section 263 of the Income Tax Act, it is observed and held that in order to exercise the jurisdiction under Section 263(1) of the Income tax Act, the Commissioner has to be satisfied of twin conditions, namely, (i) the order of the Assessing Officer sought to be revised is erroneous; and (ii) it is prejudicial to the interests of the Revenue. It is further observed that if one of them is absent, recourse cannot be had to Section 263(1) of the Act. "What can be said to be prejudicial to the interest of the Revenue" has been dealt with and considered in paragraphs 8 to 10 in the case of **Malabar Industrial Co. Ltd. (supra)**, which are as under:-

> **"8.** The phrase "prejudicial to the interests of the Revenue" is not an expression of art and is not defined in the Act. Understood in its ordinary meaning it is of wide import and is not confined to loss of tax. The High Court of Calcutta in *Dawjee Dadabhoy & Co.* v. *S.P. Jain* [(1957) 31 ITR 872 (Cal)] , the High Court of Karnataka in *CIT* v. *T. Narayana Pai* [(1975) 98 ITR 422 (Kant)] , the High Court of Bombay in *CIT* v. *Gabriel India Ltd.* [(1993) 203 ITR 108 (Bom)] and the

High Court of Gujarat in *CIT* v. *Minalben S. Parikh* [(1995) 215 ITR 81 (Guj)] treated loss of tax as prejudicial to the interests of the Revenue.

9. Mr Abraham relied on the judgment of the Division Bench of the High Court of Madras in *Venkatakrishna Rice Co.* v. *CIT* [(1987) 163 ITR 129 (Mad)] interpreting "prejudicial to the interests of the Revenue". The High Court held:

"In this context, (it must) be regarded as involving a conception of acts or orders which are subversive of the administration of revenue. There must be some grievous error in the order passed by the Income Tax Officer, which might set a bad trend or pattern for similar assessments, which on a broad reckoning, the Commissioner might think to be prejudicial to the interests of Revenue Administration."

In our view this interpretation is too narrow to merit acceptance. The scheme of the Act is to levy and collect tax in accordance with the provisions of the Act and this task is entrusted to the Revenue. If due to an erroneous order of the Income Tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial to the interests of the Revenue.

10. The phrase "prejudicial to the interests of the Revenue" has to be read in conjunction with an erroneous order passed by the Assessing Officer. Every loss of revenue as a consequence of an order of the Assessing Officer cannot be treated as prejudicial to the interests of

> the Revenue, for example, when an Income Tax Officer adopted one of the courses permissible in law and it has resulted in loss of revenue; or where two views are possible and the Income Tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interests of the Revenue unless the view taken by the Income Tax Officer is unsustainable in law. It has been held by this Court that where a sum not earned by a person is assessed as income in his hands on his so offering, the order passed by the Assessing Officer accepting the same as such will be erroneous and prejudicial to the interests of the Revenue. (See *Rampyari Devi Saraogi* v. *CIT* [(1968) 67 ITR 84 (SC)] and in *Tara Devi Aggarwal* v. *CIT* [(1973) 3 SCC 482 : 1973 SCC (Tax) 318 : (1973) 88 ITR 323] .)"

7.2 Thus, even as observed in paragraph 9 by this Court in the case of **Malabar Industrial Co. Ltd. (supra)** that the scheme of the Act is to levy and collect tax in accordance with the provisions of the

Act and this task is entrusted to the Revenue. It is further observed that if due to an erroneous order of the Income Tax Officer, the Revenue is losing tax lawfully payable by a person, it will certainly be prejudicial to the interests of the Revenue. However, only in a case where two views are possible and the Assessing Officer has adopted one view, such a decision, which might be plausible and it has resulted in loss of Revenue, such an order is

not revisable under Section 263.

7.3 Applying the law laid down by this Court in the case of **Malabar Industrial Co. Ltd. (supra)** to the facts of the case on hand and even as observed by the Commissioner, the order passed by the Assessing Officer is erroneous as well as prejudicial to the interest of the Revenue. Having gone through the assessment order as well as the order passed by the Commissioner of Income Tax, we are also of the opinion that the assessment order was not only erroneous but prejudicial to the interest of the Revenue also. In the facts and circumstances of the case, it cannot be said that the Commissioner exercised the jurisdiction under Section 263 not vested in it. The erroneous assessment order has resulted into loss of the Revenue in the form of tax. Under the Circumstances and in the facts and circumstances of the case narrated hereinabove, the High Court has committed a very serious error in setting aside the order passed by the Commissioner passed in exercise of powers under Section 263 of the Income Tax Act.

8. In view of the above and for the reasons stated above, present appeal succeeds. The impugned judgment and order passed by the High Court is hereby quashed and set aside and that the order passed by the Commissioner passed in exercise of

powers under Section 263 of the Income Tax Act is hereby restored.

In result, present appeal is allowed. However, in the facts and circumstances of the case, there shall be no order as to costs.

……J.
[M.R. SHAH]

NEW DELHI;.....J.
APRIL 06, 2023. **[A.S. BOPANNA]**