

Delhi HC quashed reassessment on 'Oriental Insurance' as reason to believe of AO was found erroneous

Summary – The High Court of Delhi in a recent case of Oriental Insurance Co., (the Assessee) held that where in case of assessee carrying on general insurance business, assessment order was passed accepting assessee's claim that in view of omission of clause (b) of rule 5 of First Schedule of Income-tax Act w.e.f. 1-4-1989, profit from sale of investment was exempt from tax, Assessing Officer subsequently could not reopen assessment merely on basis of change of opinion that aforesaid income was liable to tax

Facts

- The assessee-company was engaged in the business of General Insurance comprising of Fire, Marine and Miscellaneous Insurance Business.
- In view of the omission of clause (b) of rule 5 of the First Schedule of Income-tax Act with effect from 1-04-1989 and in terms of the CBDT Circular No. 528, dated 16-12-1988, providing explanatory notes to Finance Act, 1988. The assessee filed its return wherein profit on sale of investment was claimed exempt from tax.
- The Assessing Officer took a view that after the omission of clause (b) of rule 5 of the First Schedule of the Act, neither the losses on depreciation of investments were allowable as a deduction nor were the profits on sale/redemption of investments taxable.
- Subsequently, the Assessing Officer issued a notice under section 148 as he was of the view that income from sale/redemption of investments had escaped assessment and initiated proceedings under section 147. The Assessing Officer passed reassessment order wherein income from sale of investment was brought to tax.
- The Commissioner (Appeals) as well as the Tribunal upheld the validity of reassessment proceedings. The authorities below confirmed the addition on merits as well.
- The assessee filed instant appeal contending that reopening of assessment was based on mere change of opinion and thus impugned reassessment order deserved to be set aside.

Held

- It is now well established that the powers under section 147 of an Assessing Officer can be invoked only in cases where the Assessing Officer has reason to believe that the income chargeable to tax has escaped assessment. It has been held in several decisions that reason to believe must be based on tangible material and cogent facts; the powers under section 147 cannot be exercised merely on suspicion or on an apprehension that the income of an assessee has escaped assessment.
- A *bona fide* reason to believe that income has escaped assessment is a necessary pre-condition that clothes the Assessing Officer with the power to reopen the assessment, which has otherwise attained finality. The reasons to believe must have a 'direct nexus' and a 'live link' with the

formation of an opinion by the Assessing Officer that taxable income of an assessee has escaped assessment.

- It is not disputed that the reasons that led the Assessing Officer to reopen the assessment were factually incorrect. It is not disputed that the assessee was carrying on only one business - General Insurance Business, which is regulated under the Insurance Act, 1938. Indisputably, the insurers cannot carry on any business other than the insurance business or any prescribed business. The business of General Insurance is regulated and there is no allegation that the regulatory authority has found the assessee to be in default of any provisions of the Insurance Act, 1938. The revenue also did not dispute that the Assessing Officer's assumption that the assessee was carrying on two streams of business was incorrect. Thus, this reason to believe that the Assessee's income had escaped assessment is clearly without any factual basis.
- The assumption that the assessee had not credited the profits in question to the Profit and Loss Account was also found, factually incorrect. Thus, the reasons which led the Assessing Officer to form a belief that income of the assessee had escaped assessment are admittedly based on palpably incorrect assumptions. It is well established that reasons to believe that income had escaped assessment is a necessary pre-condition for the Assessing Officer to assume jurisdiction. Clearly, it would be difficult to sustain that this pre-condition is met if such reasons to believe that income of an assessee has escaped assessment are based on palpably erroneous assumptions.
- The reason to believe must be predicated on tangible material or information. A reason to suspect cannot be a reason to believe; the belief must be rational and bear a direct nexus to the material on which such a belief is based. In the present case, the very assumption on the basis of which the Assessing Officer is stated to have formed his belief that the assessee's income had escaped assessment has been found to be erroneous. There was no basis for the Assessing Officer to assume that the assessee had not credited the profits from the sale of investments, which are alleged to have escaped assessment in its Profit and Loss account.
- Before the Tribunal, the revenue had contended that the errors in the reasons recorded were minor errors, which did not detract from the fact that income had escaped assessment. This contention is without merit as reasons to believe that income had escaped assessment is a necessary pre-condition which enables the Assessing Officer to assume jurisdiction to proceed further. In the event such reasons are found to be erroneous, the Assessing Officer would not have the jurisdiction to make an assessment and any proceedings initiated on the basis of palpably erroneous reasons would be without authority of law. Therefore, even if it is assumed that, infact, the assessee's income has escaped assessment, the Assessing Officer would have no jurisdiction to assess the same if his reasons to believe were not based on any cogent material. In absence of the jurisdictional pre-condition being met to reopen the assessment, the question of assessing or reassessing income under section 147 would not arise. Thus, the proceedings under section 147 are liable to be quashed as being without jurisdiction.

- The next issue to be addressed is whether the Assessing Officer would have jurisdiction to examine the question as to the taxability of the profits and gains from sale of securities as it is contended that the Assessing Officer had already expressed his opinion in that regard in the initial assessment. According to the assessee, the decision of the Assessing Officer to tax profits and gains from sale of investments, amounts to a change of opinion, which is impermissible under section 147.
- By virtue of section 44 the income of an insurance company is to be computed in accordance with the Rules contained in the First Schedule of the Act. Rule 5 of the First Schedule provides for computation of profits and gains of insurance business other than life insurance business.
- By virtue of Finance Act, 1988, clause (b) of rule 5 of the First Schedule of the Act was deleted. In the initial assessment proceedings relevant to the assessment year 2004-05, the assessee claimed a deduction in respect of a sum of Rs. 3,57,54,000 on account of amount written off in respect of depreciated investments. The assessee contended that the deletion clause (b) of rule 5 did not affect the deduction claimed as the same had been debited to the profit & loss account and was not representing any loss on realization of investments.
- The Assessing Officer rejected the above contention of the assessee and held that the intention of the Legislature in deleting clause (b) of rule 5 of the First Schedule of the Act was to exempt all types of gains on investments whether by way of appreciation or by way of realization and simultaneously to disallow all types of losses on investments whether by way of depreciation or by way of realization.
- It is at once clear from the above that the Assessing Officer had expressed its firm opinion that profits and gains on realization of investments were exempt from taxation. Admittedly, such profits had been included by the assessee in its profit & loss account, which was subjected to scrutiny in the assessment proceedings.
- In the above circumstances, it cannot be disputed that the exemption claimed by the assessee in respect of the profit on sale/redemption of investments was duly disclosed and the Assessing Officer had also opined on the merits of the taxability of profits on sale/redemption of investments. The income from profit on sale/redemption of investments is now sought to be taxed as income which had escaped assessment. This, clearly represents a change in the opinion with regard to the taxability of the income in question. It is well settled that the power under section 147 is not a power of review but a power to reassess. Permitting reopening of assessment on a change of opinion as to the taxability of the income of the assessee is, thus, outside the scope of section 147.
- In view of the aforesaid, there is merit in the contention of the assessee that the Assessing Officer did not have the jurisdiction to tax the profits and gains from sale/realization of investments under section 147.
- The appeal is allowed.