

Various hues of Draft Assessment Orders – Section 144B and Section 144C

The concept of draft assessment order and final assessment order is an interesting concept to study under the Transfer Pricing (for brevity 'TP') Regulations. Under the old provisions of the Income Tax Act, 1961 (for brevity 'ITA'), the concept of passing of draft assessment order was limited to transfer pricing matters and adjustment made in respect of a non-residents. Section 144C of ITA mandates the assessing officer to pass a draft of the assessment order in respect of an eligible assessee before passing the final assessment order. The objective of insertion of Section 144C is to speedy redressal of the issue by a three-member forum called 'dispute resolution panel' (for brevity 'DRP') instead of single member forum of Commissioner of Income Tax (Appeals). Even though Section 144C was effective from October 01, 2009, the concept of draft assessment order is still a contentious issue at appellate fora.

While the issue surrounding the concept of draft assessment order under Section 144C is settling down, a new concept of draft 'assessment order', 'final draft assessment order' or 'revised draft assessment order' under Section 144B has come up with litigation at the judicial fora. In this article, the concept of draft assessment order under 144C and 144B has been dealt with in detail.

Draft Assessment Order under Section 144C:

Section 144C states that *'The Assessing Officer shall, notwithstanding anything to the contrary contained in this Act, in the first instance, forward a draft of the proposed order of assessment (hereafter in this section referred to as the draft order) to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation which is prejudicial to the interest of such assessee.'*

Applicability of Draft Assessment Order:

While reading the above section, it can be understood that passing of draft assessment order is mandatory as it contains *non-obstante* clause. Further, Section 144C states that such draft assessment order is mandatory, if the assessing officer (for brevity 'AO') proposes to make any variation on or after the 1st day of October 2009. The section does not provide that these provisions are applicable only in respect of Assessment Year (for brevity 'AY') 2009-10 but applies to every order passed or after such date.

Now, it is settled position that issue of draft assessment order is mandatory before passing the final assessment order. The same view has been upheld by many judicial fora¹ and special leave petition (for brevity 'SLP') filed by the revenue has also been dismissed by the Hon'ble Supreme Court². The reason behind said judicial precedents is that the assessee shall not be denied the legal benefit provided under the statute to approach DRP in relation to any variation which is prejudicial to the interest of the assessee.

Issue of 'Corrigendum' to Final Assessment Order to cure the mistake:

In some of the cases, the revenue has passed the final assessment order without passing the draft assessment order. Thereafter, the AO has issued a corrigendum to such final assessment order to treat the assessment order passed as draft assessment order.

In this regard, the Madras High Court in the case of Vijay Television (P.) Ltd³ has held that the AO has no right to pass the final assessment order pursuant to the Transfer Pricing Officer's (for brevity 'TPO') Order. The High Court has found that the corrigendum issued by the AO makes it clear that AO has passed the final assessment order in the first instance and a corrigendum is issued to consider such order as draft assessment order. The

¹ [W.P. No. 5557 of 2012]

² CC 16694 of 2013

³ [2014] 46 taxmann.com 100 (Madras)

assessment order passed by the AO has been accompanied by demand notice and penalty notice which can be issued only after the completion of assessment and upon passing of final assessment order. By noting the above, the High Court has held that when there is a statutory violation in not following the procedure prescribed, such an order cannot be cured by merely issuing a corrigendum.

The Mumbai High Court in the case of Lionbridge Technologies (P.) Ltd⁴ has held that AO can pass the final assessment order only after the disposal of the representations by the DRP. The Court has further rejected the claim of the revenue which has argued that the assessee has approached the DRP against the order passed by the AO which indicates such assessee has accepted the order of AO. In this regard, the court has held that mere consent of parties does not bestow jurisdiction, if the order is beyond jurisdiction and doctrine of estoppel cannot be applied against the assessee.

The Delhi Tribunal in the case of Capsugel Healthcare Limited⁵ has held that a show cause notice issued by the AO cannot be equated with draft assessment order and rejected the plea of the revenue which has argued that this lapse on the part of the AO is at best a procedural lapse and hence, the matter to be restored the file to the file AO. This view has been upheld by the Jaipur Tribunal in the cases of Jaipur Rugs Company (P) Ltd⁶ and Century Infra Power (P) Ltd⁷.

Upon reading of the above judicial precedents, it can be understood that passing of the draft assessment order is mandatory in law and mistake of passing of final assessment order cannot be cured by merely issuing a corrigendum by the AO even such order is objected before the DRP.

Revisionary powers under Section 263 vis-à-vis Draft Assessment Order:

Section 263 of the ITA provides that PCCIT⁸, CCIT⁹, PCIT¹⁰ or CIT¹¹ may call and examine the records of any proceedings under the ITA. And, if he so considers that any order passed by therein by the AO is erroneous in so far as it is prejudicial to the interest of the revenue, he may, after giving an opportunity of being heard to the assessee, pass the order including enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment.

The question arises is, whether CIT can revise the assessment order, passed by the AO wherein the AO has issued assessment order without passing the draft assessment order. In order to invoke Section 263, it has to be substantiated that order passed by AO is erroneous and such order is prejudicial to the interest of the revenue. However, in case of passing the final assessment order without passing the draft assessment order, many High Courts have held that final assessment order passed by the AO is null and void and when such order is null and void, the question of revision of order under Section 263 should not arise.

In the case of Gigabyte Technology (India) (P.) Ltd.¹², AO has passed the final assessment order without passing the draft assessment order. However, assessee has not made any appeal in respect of final assessment order. Thereafter, CIT has invoked the revisionary powers under Section 263 and passed an order to set aside the assessment order and ordered the AO to pass draft assessment order. In respect of this revisionary powers, the ITAT has held that as the assessee has not filed any appeal in respect of original assessment order, the same

⁴ [2018] 100 taxmann.com 413 (Bombay)

⁵ TS-317-ITAT-2014(DEL)-TP

⁶ TS-415-ITAT-2018(JPR)-TP

⁷ [2019] 111 taxmann.com 384 (Jaipur - Trib.)

⁸ Principal Chief Commissioner of Income Tax

⁹ Chief Commissioner of Income Tax

¹⁰ Principal Commissioner of Income Tax

¹¹ Commissioner of Income Tax

¹² [2020] 121 taxmann.com 301 (Bombay)

would be treated as in existence and cannot be called as null and void and upheld the revisionary powers under section 263. The Hon'ble High court has observed that no satisfaction is recorded by the CIT on the aspect of assessment being prejudicial to the interest of revenue. Without going to the merits of the case, the High Court has held that at the absence of such recording, revisionary provisions cannot be invoked under section 263.

The High court has further observed that ITAT has virtually permitted the CIT to not only assume the revisional jurisdiction, in absence of satisfaction of one of the twin conditions, it further permitted the CIT to even extend the period for completion of the assessment in terms of sections 143 and 144C of the ITA. In respect of assessment order, the High Court has opined that ITAT cannot ignore the judicial precedents of various courts merely because the assessee has not filed writ petition against the same.

The Pune Tribunal in the case of Agfa India (P.) Ltd¹³ has held that CIT cannot invoke revisionary powers under Section 263 in respect of final assessment order passed by the AO. Before the ITAT, the revenue has contested that the order passed by the AO is not declared as null and void by any competent authority as the appeal is pending before the CIT (A). When the appeal is pending before the CIT (A), the CIT on its own motion has revised the order under Section 263. However, the Tribunal has rejected the contentions of the revenue and held that the original order is null and void and when such original order null and void, CIT cannot invoke revisionary provisions under Section 263. The Tribunal further agreed with the argument of the assessee that there is no change in the adjustment by CIT revisionary order when compared to assessment order hence, question of revision should not arise.

Applicability of Draft Assessment Order for 'Remanded Back' matters:

While reading of Section 144C, the question, that arises is, whether passing of draft assessment order is mandatory in remanded back matters, whether or not draft assessment order is applicable at the time of passing the first assessment order.

The Delhi High Court in the case of Turner International India Pvt Ltd¹⁴ has held that even for remanded back matters, AO shall adhere to the provisions contained in Section 144C and shall pass draft assessment order before passing the final assessment order.

The divisional bench of the Delhi High Court in the case of JCB India Ltd¹⁵ has held that AO shall pass draft assessment order in remanded back matters. The revenue has argued that the ITAT has not set aside the total proceeding to the file of AO and it has set aside the order only with respect to TP adjustment and that too with specific direction to the AO. However, the High Court has disagreed with the revenue arguments and held that Section 144C is unambiguous and it requires that AO to pass draft assessment order as there is nothing in the wording of Section 144C (1) which would indicate that this requirement of passing a draft assessment order does not arise where the exercise had been undertaken by the TPO on remand to it, of the said issue, by the ITAT. However, the revenue has went on and argued that the order passed by the AO can be curable under Section 292B of ITA. In respect of revenue arguments, the High Court has stated that the issue involved is not about a mistake in the said order but the power of the AO to pass the order and accordingly, the High Court has dismissed the plea of the revenue.

The Delhi Tribunal in the case of Nikon India Pvt Ltd¹⁶ has observed that the AO has merely captioned the final assessment order as draft assessment order along with issuance of notices of demand under Section 156 and penalty notice under Section 274 read with Section 271 (1)(c) of ITA which means a final assessment order was

¹³ [2016] 64 taxmann.com 429 (Pune - Trib.)

¹⁴ TS-400-HC-2017(DEL)-TP

¹⁵ TS-706-HC-2017(DEL)-TP

¹⁶ TS-296-ITAT-2020(DEL)-TP

passed without passing the draft assessment order. Accordingly, the Tribunal has quashed the final assessment order passed by the AO.

Further, the Delhi High Court in the case of Headstrong Services India (P.) Ltd¹⁷ has held that in complete contravention of Section 144C, the Assessing Officer wrongfully assumed the jurisdiction and passed the final assessment order without passing a draft assessment order and without giving the respondent/assessee an opportunity to raise objections before the DRP. The Court further held that till the Income-tax Department ensures that the Assessing Officers follow the mandate of law, in particular, binding provisions like Section 144C and eschew filing of unnecessary appeals rather than in nearly all matters where the Assessing Officer has taken a view against the assessee, the assessments will not achieve finality for a number of years like in the present case. Further, SLP filed by the revenue against the order of the High Court quashing the assessment order has been dismissed by the Hon'ble Supreme Court in the cases of Control Risks India P Ltd¹⁸ and Nokia India Pvt Ltd¹⁹

After the above decisions of various High Courts and subsequent dismissal of SLP by Supreme Court, the issue surrounding the draft assessment order when remanded back matters seems to be settled down. However, the Madras High Court recently has delivered different views regarding the draft assessment order in two separate matters.

The Single member bench of the Madras High Court in the case of Durr India Private Limited²⁰ has allowed the writ petition filed by the assessee. However, the court has not quashed the assessment order but set aside the order passed by the AO and remitted the matter to AO to pass draft assessment order within 3 months from the date of receipt of High Court order. On the same day, same single member bench of the Madras High Court in the case of Volex Interconnect (India) (P.) Ltd.²¹ has held that the issue related to draft assessment order is no longer *res-integra* and allowed the plea of the assessee and thereby remitted the matter to AO to pass draft assessment order.

However, another single member bench of the Madras High Court in the case of Enfinity Solar Solutions Private Limited²² has given contradictory decision. Wherein the High Court has observed that the AO has passed the draft assessment order in the first round and ITAT has not set aside the order of the AO but remitted the matter only with respect of selection of most appropriate method (for brevity 'MAM'). Accordingly, the High Court has opined that following the entire procedure from the begging is not the idea behind the provisions Section 144C and held that in the event of again directing the authorities to follow the procedures right from the beginning, the proceedings would not only be prolonged, it will be protracted, which would provide an undue advantage to the assessee in the matter of payment of income tax. The Court has further held that if at assessee aggrieved by the order of AO subsequent of ITAT remittance, assessee can file appeal before the CIT (A) against such order.

The court has first mentioned that the ITAT has not set aside the matter and remitted the file to the AO for specific purpose. There are many judicial precedents which have held that when ITAT has remitted the file to AO for specific issue, the assessee cannot come back to ITAT after the assessment order and has to follow the procedure prescribed under the law. Interestingly, the High Court has mentioned that assessee can file appeal before the CIT(A) which may be indigestible under the ITA.

After the decision of above Madras High Court, the issue relating to draft assessment order under Section 144C may be re-ignited. However, as the decision was delivered by single member bench, the assessee may rely upon

¹⁷ [2021] 125 taxmann.com 262 (Delhi)

¹⁸ TS-170-SC-2018-TP

¹⁹ TS-1027-SC-2018-TP

²⁰ TS-487-HC-2021(MAD)

²¹ [2021] 128 taxmann.com 296 (Madras)

²² TS-488-HC-2021(MAD)

larger bench cases for remedy. In our opinion, even under remanded back matters, an assessee should be given an opportunity to file objections before the DRP as the intention behind it is to decide the matter by larger forum especially in complex matters like transfer pricing adjustments.

Revisionary Powers under Section 263 to revise Final Assessment Order & TPO Order:

The next issue is whether a CIT can invoke the provisions of Section 263 and revise the final assessment which is passed pursuant to direction issued by DRP. Section 144C (13) of ITA states, AO shall pass the final assessment order in conformity with the directions issued by the DRP which means that directions issued by the DRP are binding on the AO. DRP is a quasi-judicial authority having three-member forum and assessee approaches DRP before the completion of assessment based on draft assessment order passed by the AO.

On the other hand, Section 263 states that CIT can call and examine records of any proceedings under the Act and pass the order to including order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment. Explanation 1 (c) to section 263 states that CIT can exercise the powers under this section to the matters which are not considered and decided in any appeal if filed by the assessee.

In the case of Devas Multimedia (P.) Ltd.²³, the Karnataka High Court has held that there is no provision in Section 263 to prohibit the CIT to invoke revisionary powers to revise the final assessment order pursuant to DRP directions. The court has further held that CIT cannot sit over the three member DRP however, the subject matter under revision was not related to any objections before the DRP and hence, CIT can revise the final assessment order. The Hon'ble Kolkata Tribunal in the case of Philips India Ltd.²⁴ has analysed the issue in detail and held that CIT can revise the matters which are not subject matters before the DRP by invoking the provisions of Section 263.

The Hyderabad Tribunal in the case of Agro Tech Foods Ltd.²⁵ has held that CIT can invoke the provisions of Section 263 to revise the TPO order. The Tribunal has observed that CIT under Section 263 can call and examine records of any proceedings under the Act and can revise such order as the matters in TPO order has not been dealt with by DRP. Hence, the issue related to revision of TPO order, draft assessment order or final assessment order has to be decided only after the analysis facts of each case.

However, the CIT cannot invoke the provisions of section 263 without coming to the conclusion that the order passed by the Ld. AO is prejudicial to the interest of the revenue. The insertion of Explanation 2 to section 263 does not empower the CIT to invoke section 263 without making any enquiry to the order passed by the AO.

The Hon'ble Delhi Tribunal in the case of Amira Pure Foods Pvt Ltd²⁶ has held that CIT cannot invoke provisions of section 263 merely because the CIT feels that further enquiry should have been made in respect of submission made by the assessee. The Tribunal has concluded that it was incumbent upon CIT to make some minimal independent enquiry to reach the conclusion that the AO order is erroneous and prejudicial to the interest of the Revenue.

Following the above decision of Delhi Tribunal, the Hon'ble Jodhpur Tribunal in three cases²⁷ has quashed the revisionary order under section 263 by stating that CIT shall not invoke the revisionary powers merely on presumptions without making any enquiry to the order of the AO. The Tribunal has rejected the contention of

²³ [2019] 111 taxmann.com 494 (Karnataka)

²⁴ IT APPEAL NO. 1142 (KOL.) OF 2016

²⁵ [2021] 124 taxmann.com 517 (Hyderabad - Trib.)

²⁶ TS-1053-ITAT-2017(DEL)-TP

²⁷ Wolkem India Limited [TS-405-ITAT-2021(JODH)-TP], Secure Meters Limited [TS-406-ITAT-2021(JODH)-TP] and PI Industries Limited [TS-407-ITAT-2021(JODH)-TP].

the revenue stating that AO is not bound to make refer the matter to TPO by virtue of CBDT instruction No 3/2016.

Power of AO to review its own Draft Assessment Order:

In the case of Galaxy Surfactants Ltd.²⁸, the AO has made certain adjustments to the income in addition to the adjustment by TPO and passed draft assessment order. Thereupon, assessee has filed a letter with the AO to confirm that no objection would be filed before the DRP. However, while passing the final assessment order, the AO *suo motu* has reduced the adjustments other than TP adjustments. Subsequently, the CIT has invoked Section 263 to revise the assessment order as such order is erroneous and prejudicial to the interest of revenue by stating that AO has reduced the adjustment without recording any reasons for doing so.

In this regard, the Mumbai Tribunal has held that AO cannot review its own draft assessment order and make variation to such order except with the directions of the DRP. Accordingly, the Tribunal has upheld the invocation of Section 263 and dismissed the appeal filed by the assessee.

The objective behind the insertion of draft assessment order is to provide an opportunity to the assessee to look into variations if any made by the AO/TPO and to file objections before completing the assessment. In this part of article, we have analysed the concept and certain specific issues related to draft assessment order under Section 144C. In the next parts, we shall discuss the recourse available to the assessee upon receipt of final assessment order and thereafter, the concept and emerging issues surrounding the issue of show cause notice and 'Draft Assessment Order, 'Final Draft Assessment Order' and 'Revised Draft Assessment Order' under Section 144B of ITA under the 'Faceless Assessment Scheme.'

For further reading:

- Vijay Television (P.) Ltd. [2018] 95 taxmann.com 101 (Madras)
- Yazaki India (P.) Ltd. [2019] 108 taxmann.com 297 (Pune - Trib.)
- Inatech India (P.) Ltd. [2019] 106 taxmann.com 318 (Bangalore - Trib.)
- HSBC Invest Direct Securities (I) (P.) Ltd. [2020] 116 taxmann.com 227 (Mumbai - Trib.).
- Punjab Chemicals & Crop Protection Ltd. [2020] 113 taxmann.com 263 (Chandigarh - Trib.)

²⁸ [2021] 127 taxmann.com 383 (Mumbai - Trib.)