



IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.3056 OF 2019

The Principal Commissioner of Income Tax-25,
 Mumbai .. Petitioner

Versus

Milestone Real Estate Fund .. Respondent

UTKARSH
 KAKASAHEB
 BHALERAO

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 UTKARSH KAKASAHEB
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 Date: 2026.01.23
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Mr. Malcolm Vaz i/b Ravi Rattesar, Kiran Singh, Advocates
 for the Petitioner.

**Mr. J. D. Mistri, Senior Advocate a/w Madhur Agrawal
 i/b Kanga & Co., Advocates for Respondent.**

**CORAM : B. P. COLABAWALLA &
 FIRDOOSH P. POONIWALLA, JJ.
 DATE : JANUARY 19, 2026**

P. C.

1. The above Appeal was extensively and finally heard by us on 7th January 2026. We had stood the matter over to today for passing orders. However, from the last date to today, the assignments have changed and the Appeals of the year 2019 are no longer assigned to this Bench. However, both parties stated that since the Appeal has been finally heard and has been placed on board today for passing orders, we

should proceed to pass orders in the above Appeal. Hence, with the consent of parties, we have proceeded to pass our order.

2. The above Appeal has been filed by the Revenue challenging the order dated August 10, 2018 passed by the Income Tax Appellate Tribunal, Mumbai- 'I' Bench (for short "**ITAT**"). By the impugned order, the ITAT quashed and set aside the order dated March 28, 2018 passed by the Appellant (Pr. Commissioner of Income-tax -25, Mumbai) [for short "**PCIT**"] under Section 263 of the Act, wherein the Appellant held that the assessment order dated March 17, 2016, passed by the Assessing Officer for Assessment Year 2013-14 in case of Milestone Real Estate Fund ("**Assessee**" / "**Fund**"), is erroneous and prejudicial to the interest of the Revenue.

3. In the Appeal before us, although the Revenue has proposed various questions as substantial questions of law, the Revenue has pressed only the following question as a substantial question of law:-

"Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT has erred in setting aside the order passed by the Pr.CIT-25, Mumbai u/s 263 of the I.T. Act, 1961 and restore the order passed by the AO?"

4. To understand the controversy, it would be necessary to set out some brief facts. The Assessee is a Trust created under the Indian Trust Act, 1882 and is a Venture Capital Fund (“VCF”) which is registered with the Securities Exchange Board of India (“SEBI”) under the *SEBI (Venture Capital Funds) Regulations, 1996* (“VCF Regulations”). The primary activity of the Assessee is to float various schemes with a focus to invest primarily in entities engaged in the real estate sector dealing with immovable property of any kind and any rights and interests therein. The Fund's duration is for 20 years or until the expiry of the last scheme of the Fund, whichever is later.

5. For the assessment year under consideration (i.e. A.Y. 2013-14), the Assessee filed its return of income on July 30, 2013 declaring a total income of Rs.8,94,65,291/-. Subsequently, on November 29, 2013, the Assessee filed a revised return of income declaring a total income of Rs.14,29,12,592/-. The said amount represented income which was not exempt under Section 10(23FB) of the Income-tax Act, 1961 (“the Act”) or under Section 10(35) of the Act. The Assessee claimed the following income as exempt from tax:-

<u>Particulars</u>	<u>Amount (Rs.)</u>
Income from VCUs exempt u/s 10(23FB)	144,60,40,876
Income exempt u/s 10(35)	13,92,16,893

6. The return of income filed by the Assessee was selected for scrutiny assessment proceedings. In course of the scrutiny assessment proceedings, the Assessing Officer, while verifying the return of income filed by the Assessee, noticed that the Assessee has claimed exemption under Section 10(23FB) of the Act in respect of income earned out of investments made in Venture Capital Undertakings (**VCUs**"). The Assessing Officer called upon the Assessee to justify its claim of exemption under Section 10(23FB) of the Act on multiple occasions. A notice dated December 17, 2013 was issued under Section 143(2) of the Act seeking basic information. In response thereto, the Assessee had inter alia provided the statement of income paid or credited to unit holders in Form No.64. The Assessing Officer, thereafter, vide notice dated March 05, 2014 issued under Section 142(1) of the Act, sought a note on the nature of the business activity of the Assessee. The Assessee furnished the same along with the relevant details vide letter dated March 12, 2014. The Assessing Officer issued another notice dated September 18, 2015 under Section 142(1) of the Act asking for details regarding the claim of exemption under Section 10(23FB) of the Act.

The Assessee, vide letter dated October 13, 2015, provided detailed explanations regarding eligibility as well as working of its claim for exemption under Section 10(23FB) of the Act. The order sheet entry dated February 12, 2016 also records that the Assessing Officer asked the Assessee to furnish documentary evidences inter alia including the SEBI Certificate recognizing the Assessee as a VCF, copy of reports sent to SEBI for the relevant Financial Year 2012-13, fund-wise and investment-wise fund details, basis for differentiation of income from VCU and Non venture capital units, TDS on distribution of income to beneficiary investors, etc. and called upon the Assessee to explain as to how it is covered under Section 10(23FB) and Section 115U of the Act. All the relevant details were furnished by the Assessee vide its letter dated February 22, 2016. Another order sheet entry dated February 22, 2016, records that the Assessing Officer sought from the Assessee, details of investments made in VCUs, details of business carried on by VCUs, and whether VCUs are carrying on activities mentioned in the Third Schedule of VCF Regulations. In its reply to the said query, the Assessee, vide its letter dated February 25, 2016, provided requisite details including the fact that the Fund was floated to primarily invest in the real estate sector, which has been removed from the negative list in the Third Schedule of the VCF Regulations with effect from April 05,

2004. The Assessing Officer after verifying the explanation of the Assessee, completed the assessment vide order dated March 17, 2016 under Section 143(3) of the Act, allowing Assessee's claim of exemption under Section 10(23FB) of the Act. Paragraph 5 of the assessment order reads as under-

“ The reply of the Assessee and facts of the case were examined. The Assessee is a SEBI registered Venture Capital Fund (VCF). As per the provisions of the I.T. Act, 1961 as amended by the Finance Act, 2012 in sections 10(23FB) and 115U of the Income Tax Act, 1961 (The Act), from April 1, 2012, the income earned by Venture Capital Fund (The Fund or The Scheme) from Venture Capital Undertakings (VCUs) will be exempt from tax in the hands of the Fund and the same will be subject to tax in the hands of the investors on accrual basis. The Fund will continue to pay tax on income other than from VCUs (such as bank interest, income from mutual funds etc.). It is also noticed that the Assessee has filed the requisite Form No. 64 as per Rule 12C of the Income-tax Rules with the Commissioner of Income-tax-21, Mumbai who had the jurisdiction over the Venture Capital Fund. The Assessee has also issued Form No. 64 to respective investors of each of the Schemes. Accordingly, the contention of the Assessee is found to be correct and accepted and the entire income earned from the investments made in the Venture Capital Undertakings is to be subjected to tax in the hands of investors as per provisions of section 115U of the Act.”

7. Subsequently, a show cause notice was issued by the PCIT, under Section 263 of the Act dated February 06, 2018, alleging that the assessment order passed by the Assessing Officer is erroneous and prejudicial to the interest of Revenue. The Assessee filed its reply *inter alia* submitting that the conditions of the assessment order being erroneous or prejudicial to the interest of the revenue is not satisfied in

the present case, i.e. that the assessment order passed by the Assessing Officer is neither erroneous nor prejudicial to the interest of revenue.

8. The PCIT, however, passed an order dated March 28, 2018 under Section 263 of the Act, setting aside the assessment order passed under Section 143(3) of the Act, holding that the assessment order for the A.Y.2013-14 is erroneous and prejudicial to the interest of the Revenue. The PCIT held that the assessment order was set-aside to verify the claim for exemption under Section 10(23FB) of the Act *inter alia* on the following grounds:

(a) The investment made by the Assessee in VCUs which are engaged in the real estate sector are not eligible VCUs for the purpose of Section 10(23FB) of the Act. The PCIT accepted the contention of the Assessee that the Assessee's case is governed by the VCF Regulations and not SEBI AIF Regulations, however, drawing an analogy between the definition in the VCF Regulations and SEBI AIF Regulations, the PCIT was of the view that the intention of the legislature is to permit exemption only to such sectors which are involved in providing services and production

and manufacturing of articles or things, and therefore, the real estate sector does not come within the ambit of a VCU.

- (b) By making investment in mutual funds, the Assessee has violated SEBI Regulations as investment in mutual funds is not as per the investment conditions mentioned in the VCF Regulations, and therefore, the Assessee is not eligible for exemption under Section 10(23FB) of the Act.
- (c) By investing in the real estate sector, the Assessee never intended to engage in any other activity except sale and purchase of immovable properties. Such activity is not within the ambit of the VCF Regulations, and hence, the Assessee is not eligible for exemption under Section 10(23FB) of the Act.

9. Being aggrieved by the order of the PCIT passed under Section 263 of the Act, the Assessee preferred an appeal before the ITAT.

10. The ITAT, vide its order dated August 10, 2018, set aside the order passed by the PCIT under Section 263 of the Act. The ITAT held that the revision undertaken by the PCIT was not in accordance

with the provisions of Section 263 of the Act. The ITAT further held that even on the merits, the Assessee is entitled to exemption under Section 10(23FB) of the Act. The ITAT, in paragraph 21 of the impugned order, noted that during the course of the assessment proceedings, the Assessing Officer had *inter alia* called for the following details:

- a. computation of total income;
- b. return of income;
- c. audited financial statements;
- d. income credited to unit holders – Form 64;
- e. detailed note on nature of activity;
- f. details for claim of exemption under section 10(23FB) of the Act;
- g. SEBI VCF Regulation Certificate;
- h. books of account;
- i. Reports filed with SEBI;
- j. details of investment fundwise;
- k. how it is covered and eligible for exemption under Section 10(23FB) of the Act;
- l. difference in income from the VCU and non VCU;
- m. TDS on distribution of income to unit holders;
- n. Investments made in VCUs, nature of activity of VCUs, whether the VCUs are carrying on activities which are in negative list.

11. The ITAT held that the Assessee had duly filed all the details from time to time during the course of assessment proceedings, including investments in VCU, their nature of activity being investments

in the real estate sector, and the fact of the said activity not being in the negative list. Accordingly, the ITAT opined that the Assessing Officer, after considering the submissions of the Assessee and applying his mind to the relevant statutory provisions as well as material brought on record, completed the assessment allowing the Assessee's claim of exemption under Section 10(23FB) of the Act. The ITAT therefore held that it is not a case where the Assessing Officer has either not conducted any enquiry or has accepted the Assessee's claim without applying his mind to the facts and material on record or the relevant statutory provisions. The ITAT therefore held that the view taken by the Assessing Officer in allowing the Assessee's claim for exemption under Section 10(23FB) of the Act, is certainly a possible view and therefore, the assessment order cannot be held to be erroneous.

12. The ITAT further held that in compliance with the provisions of Section 115U of the Act, the Assessee has submitted statements in Form No.64 before the appropriate authority and there is no adverse observation by the concerned authority that the Assessee has violated the conditions of Section 115U of the Act. The ITAT further observed that thus, looked at from this angle, there is no prejudice caused to the Revenue as the disputed income has been subject to tax,

though, not in the hands of the VCF, but in the hands of the unit holders. Hence, no prejudice is caused to the revenue. Hence, the twin conditions of Section 263 of the Act are not fulfilled in the present case, was the finding of the ITAT.

13. The ITAT, on merits also, held that the VCUs in which the Assessee has made investments are not in the Negative List under the VCF Regulations; all the VCUs, wherein the Assessee made investments, are doing business in the real estate sector which sector had been removed from the negative list under the Third Schedule of the VCF Regulations with effect from April 05, 2004. That being the case, the assessment order allowing exemption under Section 10(23FB) of the Act cannot be said to be erroneous on the ground that the real estate sector is not covered under the VCU. The ITAT held that the PCIT erred in relying on the *Securities and Exchange Board of India (Alternate Investment Funds) Regulation, 2012* whereas Assessee is governed by *Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996*. The ITAT further held that only because the Assessee has invested in VCUs which are in the real estate sector, it cannot be said that the Assessee is also engaged in the real estate business of purchase and sale of immovable property.

14. The ITAT held that though the learned PCIT has observed that the Assessee has violated the conditions imposed under the SEBI Regulations by investing in mutual funds, she has not specified which provision of the SEBI Act or Regulations have been violated. The ITAT held that on carefully going through the VCF Regulations, the ITAT was unable to locate any restriction/condition imposed therein prohibiting the Assessee from investing in mutual fund units. The ITAT further referred to the clarification issued by SEBI, wherein it was specifically stated that there is no prohibition in investing surplus funds available with the VCF in short term liquid mutual funds.

15. The ITAT has further observed that the allegation of breach/violation of SEBI Regulation had originated from the PCIT whereas there is no such allegation of violation from SEBI, which is the competent authority (to look into any violation), neither the registration certificate granted has been withdrawn by SEBI, nor any action has been taken against the Assessee for any violation alleged by the learned PCIT. The ITAT, accordingly, held that the reasoning of the learned PCIT that the Assessee has violated SEBI Regulations, and hence is not eligible to

avail of exemption under Section 10(23FB) of the Act was unsustainable.

16. Finally, the ITAT came to the conclusion that the Assessing Officer, while accepting the Assessee's claim of exemption under Section 10(23FB) of the Act, has made an extensive enquiry and applied the law correctly to the facts brought on record, and the assessment order passed can neither be held to be erroneous nor prejudicial to the interests of Revenue, and the Assessee is therefore bound to succeed on both, lack of jurisdiction to exercise powers under Section 263 of the Act, as well as on merits.

17. The Revenue has filed the present Appeal to challenge this order of the ITAT. In the backdrop of what we have narrated above, the learned counsel for the Revenue, Mr. Ravi Rattesar, relying on the order of the PCIT, submitted that the ITAT has erred in setting aside the order of the PCIT. The learned counsel argued that:—

(a) The investment made by the Assessee in VCUs which are engaged in the real estate sector are not eligible VCUs for the purpose of Section 10(23FB) of the Act. The main thrust of the Government is to promote sectors like services,

manufacture or production sectors, and the real estate sector is not covered in the definition of a VCU. If the contention of the Assessee were to be accepted, it would then lead to a broader definition of a VCU, which is definitely not the intention of the legislature for granting exemption under Section 10(23FB) of the Act.

- (b) By making investment in mutual funds, the Assessee has violated SEBI Regulations as investment in mutual funds is not as per the investment conditions mentioned in the VCF Regulations. The Assessee as a VCF could only invest in privately negotiated equity, equity related and other permitted investments in Indian entities carrying on any business permitted under the regulations which are required to be VCUs in terms of the Explanation to Section 10(23FB) of the Act. Investment in mutual funds is not a permitted investment. Such investment is in breach of SEBI (VCF) Regulation, 1996, and therefore, the Assessee is not eligible for exemption u/s 10(23FB) of the Act.
- (c) The Assessee acquires ownership rights in the VCU through acquiring controlling stake without making any investment and subsequently introducing the funds through purchase of

Optionally Fully Convertible Debentures (“**OFCD**”) of the company developing real estate project. After substantial progress in the project, the Assessee sells its stake to vendors along with redemption of the OFCDs issued by the company, thereby withdrawing its entire investment from a particular undertaking. This particular transaction is akin to sale and purchase of a real estate project from one hand to another hand through sale of the controlling stake in the company. Therefore, it is clear that the Assessee never had the intention of any other activity except sale and purchase of immovable properties. Such activity is not within the ambit of the VCF Regulations, and hence, the Assessee is not eligible for exemption under Section 10(23FB) of the Act.

18. Mr. Mistri, the learned senior counsel appearing on behalf of the Assessee, submitted that the ITAT was correct in setting aside the order of the PCIT and submitted as under:–

(a) The ITAT at paragraph 21 of its order has recorded a categorical factual finding that the Assessing Officer conducted a detailed enquiry with respect to the claim of deduction and after considering the submission of the Assessee had recorded

a categorical finding in the assessment order at paragraph 5, which is extracted hereinabove. Therefore, it is clearly a case where the Assessing Officer has enquired into the issue in detail and decided that the Assessee is entitled to exemption under Section 10(23FB) of the Act. Accordingly, the view taken by the Assessing Officer in allowing Assessee's claim for exemption under Section 10(23FB) of the Act, is certainly a possible view, and therefore, the assessment order cannot be held to be erroneous.

(b) The Tribunal has recorded a categorical factual finding that in compliance with the provisions of Section 115U of the Act, the Assessee has submitted statements in Form No.64 before the appropriate authority and there is no adverse observation by the concerned authority that the Assessee has violated the conditions of Section 115U of the Act. Therefore, as the disputed income has been subjected to tax, even though, not in the hands of the VCF but in the hands of the unitholders, no prejudice is caused to the Revenue. Thus, the assessment order cannot be said to be prejudicial to the interest of the revenue.

(c) The assessment order cannot be said to be erroneous as the allegation of the PCIT that the investment in the real estate

sector is not an investment in a VCU is itself contrary to law. The Tribunal held that the VCUs in which the Assessee has made investment are not in the Negative List under the VCF Regulations. The Assessee made investments in entities which are doing business in the real estate sector. The real estate sector has been removed from the Negative List under the third Schedule of the VCF Regulations with effect from April 05, 2004. Further, the PCIT erred in relying on the *Securities and Exchange Board of India (Alternate Investment Funds) Regulation, 2012* when the Assessee is governed by the *Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996*.

(d) The allegation of the PCIT that the Assessee is engaged in buying and selling real estate is clearly unsustainable as the Assessee is merely holding securities of the entities which are engaged in real estate activity and the Assessee itself is not engaged in the real estate activity. If the allegation of the Revenue is treated as correct, then in every case it will be alleged that the VCF has not invested in the VCU but is itself carrying on the activity of buying and selling of real estate, or other activity of the VCU, which is an absurdity.

(e) The Tribunal has considered the VCF Regulations and concluded that there is no restriction/condition imposed therein prohibiting the Assessee from investing in mutual funds. The Tribunal has also referred to the clarification issued by SEBI, wherein it has been specifically stated that there is no prohibition in investing surplus funds available with the VCF in short term liquid mutual funds. When the authority which is governing the VCFs has itself clarified the issues, it is not open to the PCIT to allege that the VCF guidelines have been violated. Mr.Mistri, referred to the Tribunal's finding that the allegation of breach/violation of SEBI Regulations has originated from the PCIT whereas there is no such allegation of violation from SEBI, which is the competent authority (to look into any violation), neither the registration certificate granted has been withdrawn by SEBI, nor any action has been taken against the Assessee for any violation alleged by the learned PCIT.

19. In conclusion, Mr.Mistri submitted that no substantial question of law arises for consideration, and hence, the appeal should be dismissed.

20. Mr.Ravi Rattesar, learned advocate appearing on behalf of the Appellant has filed short arguments of the Appellant. Mr. J. D. Mistri, learned Senior Advocate, appearing for the Respondent, has filed a brief synopsis of the matter.

21. We have heard Mr.Ravi Rattesar, the learned Advocate appearing on behalf of the Appellant, as well as Mr. J. D. Mistri, learned Senior Advocate, appearing for the Respondent.

22. We note that Section 10(23FB) of the Act was introduced by the Finance Act, 2000 with effect from April 01, 2001. The aforesaid provision provides for exemption from tax of any income of a VCF from investment in a VCU. Simultaneously with the introduction of Section 10(23FB) of the Act, Section 115U of the Act was also introduced which provided for taxation of income derived by a VCF from a VCU in the hands of the unit holders who have made investments in the VCF, as if, the income received by the VCF from the VCU is directly received by the unit holders from the VCU. Thus, we note that a VCF was given a pass through status i.e. income derived by them from the VCU will be exempt

in the hands of the VCF but would be taxable in the hands of the unit holders.

23. The definition of a VCU was amended by the Finance Act, 2007 with effect from 1st April, 2008 (i.e. Assessment Year 2008-2009) to provide that a VCU shall only include undertakings engaged in certain specified activities (sectors). Thus, after the aforesaid amendment, income of every VCF was no longer exempt from tax but only income from investment in VCU's engaged in specified sectors was exempt from tax in the hands of VCF. Investment in the real estate sector was not one of the specified activities.

24. By the Finance Act, 2012, Section 10(23FB) of the Act was again amended with effect from 01/04/2013 (Assessment Year 2013-14) as per which a VCU was defined to mean a VCU as per clause (n) of Regulation 2 of the VCF Regulations. Thus, the original position was restored, and the sectoral restriction was removed from the definition of a VCU, with effect from A.Y.2013-14.

25. Section 10(23FB) of the Act was thereafter once again amended by the Finance Act, 2013 with effect from 01/04/2013

(Assessment Year 2013-14) to amend the definition of a VCF. The aforesaid amendment was made to *inter alia* give pass through status to Alternate Investment Funds (“AIFs”) registered on or after May 21, 2012 and as such the said amendment has no application to VCFs which are already granted exemption vide Finance Act, 2012 with effect from Assessment Year 2013-14 onwards.

26. Clause (n) of Regulation 2 of the VCF Regulations reads as under:-

- (n) “venture capital undertaking” means a domestic company—
 - (i) whose shares are not listed on a recognized stock exchange in India;
 - (ii) which is engaged in the business for providing services, production or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of the Central Government by notification in the Official Gazette in this behalf.

27. The relevant extract of the amended Schedule III of the SEBI Regulations with effect from 05-04-2004 is reproduced hereunder for ease of reference:-

¹/THIRD SCHEDULE

*Securities and Exchange Board of India
(Venture Capital Funds) Regulations, 1996
[See Regulation 2(3)]*

NEGATIVE LIST

(1) ²[*]**

(2) *Non-banking financial services 3[excluding those Non-Banking Financial Companies which are registered with Reserve Bank of India and have been categorized as Equipment Leasing or Hire Purchase Companies].*

(3) *Gold financing 4[excluding those Companies which are engaged in gold financing for jewellery].*

(4) *Activities not permitted under industrial policy of Government of India.*

(5) *Any other activity which may be specified by the Board in consultation with Government of India from time to time.]*

1 Inserted by the SEBI (Venture Capital Funds) (Amendment) Regulations, 2000, w.e.f. 15-09-2000.

2 Words “Real Estate” omitted by the SEBI (Venture Capital Funds) (Amendment) Regulations, 2004, w.e.f. 05-04-2004.

3 Inserted, ibid.

4 Inserted, ibid.

28. Accordingly, “real estate” has been removed from the Negative List with effect from April 05, 2004.

29. In the backdrop of the aforesaid legal position, we have to consider whether the ITAT was justified in quashing the order passed by the PCIT under Section 263 of the Act. Having considered the orders of

the lower authorities, and the arguments of the parties, we find that the Assessing officer has examined the claim of exemption under Section 10(23FB) of the Act in detail at the time of passing the original assessment order dated March 17, 2016. The ITAT has noted this irrefutable position, and in paragraph 21 and 22 of its order has held as under:–

“21. Keeping in perspective the aforesaid statutory provisions let us examine the facts of the present appeal. Undisputedly, the Assessee in the revised return of income filed for the impugned assessment year has claimed deduction under section 10(23FB) of the Act. It is also a fact that the return of income filed by the Assessee was selected for scrutiny and in course of the assessment proceedings, in response to the notice dated 17th December 2013 issued under section 143(2) of the Act the Assessee vide letter dated 26th December 2013, furnished copy of computation of income, return of income, audited financial statements and statement of income paid or credited to unitholders in Form no.64 which is required to be furnished under section 115U of the Act. The Assessing Officer after verifying the details furnished by the Assessee and noticing that the Assessee has claimed exemption under section 10(23FB) of the Act as a Venture Capital Fund issued a notice under section 142(1) of the Act on 5th March 2014, requiring the Assessee to furnish various details including a note on nature of business activity. In response to the said notice, Assessee vide letter dated 12th March 2014 furnished the required details along with supporting documents. Subsequently, the Assessing Officer issued a notice under section 142(1) of the Act on 18th September 2015 requiring the Assessee to furnish necessary details regarding its claim of exemption under section 10(23FB) of the Act. In response to the said notice, the Assessee filed its submissions before the Assessing Officer on 13th October 2015 explaining in detail its eligibility to claim exemption under section 10(23FB) of the Act. A detailed working of the income derived and exemption claimed was also furnished before the Assessing Officer. After verifying such details furnished by the Assessee, the Assessing Officer again vide order sheet entry dated 12th February 2016 called upon the Assessee to furnish further documentary evidences like registration certificate issued by the SEBI recognising the Assessee as Venture Capital Fund, books of account in soft copy, copy of

all reports sent to SEBI for financial year 2012-13, details of fund-wise and investment-wise fund etc. The Assessing Officer also called upon the Assessee to explain how it is covered under section 10(23FB) and section 115U of the Act. He also asked the Assessee to provide the basis of differentiation of income from Venture Capital Units and Non venture Capital Units. He also called for details of TDS made on distribution of income to beneficiary investors. In response to above queries, the Assessee vide reply dated 22nd February 2016 furnished all the required details as called for by the Assessing Officer including the quarterly reports submitted to the SEBI, copy of statement in Form no.64, registration certificate issued by the SEBI, fund-wise and investment-wise details, etc. On the very same day, the Assessing Officer, through order sheet entry, called upon the Assessee to furnish details of investment made in Venture Capital Undertakings in respect of all the funds as well as the details regarding the nature of business activities carried on by the Venture Capital Undertakings and also to explain whether the Venture Capital Undertakings are carrying on activities which are in the negative list as mentioned in the Third Schedule of Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996. He directed the Assessee to comply with these queries on 25th February 2016. In response, the Assessee vide reply dated 25th February 2016 submitted the details in respect of the investment made in Venture Capital Undertaking as well as the business activity of the Venture Capital Undertakings. In the said reply, it was submitted by the Assessee that the fund was created to float various schemes with focus to invest primarily in entities engaged in the real estate sector. The Assessee referring to the negative list as per the Third Schedule of Securities and Exchange Board of India (Venture Capital Funds), Regulations 1996 submitted that real estate sector is no longer appearing in the negative list as it has been taken out from the negative list by SEBI (Venture Capital Funds)(Amendment) Regulations, 2004 w.e.f. 5th April 2004. Thus, it was submitted, the Assessee is eligible to avail exemption under section 10(23FB) of the Act.

22. The Assessing Officer after considering the submissions of the Assessee and applying his mind to the relevant statutory provisions as well as material brought on record, ultimately completed the assessment on 17th March 2016, allowing Assessee's claim of exemption with the following observations:—

"5. The reply of the Assessee and facts of the case were examined. The Assessee is a SEBI registered Venture Capital Fund (VCF). As per the provisions of the I.T. Act, 1961, as amended by the Finance Act, 2012, in section 10(23FB) and

115U of the Income-tax Act, 1961, (The Act), from April 1, 2012, the income earned by Venture Capital Fund (The Fund or The Scheme) from Venture Capital Undertakings (VCUs) will be exempt from tax in the hands of the Fund and the same will be subject to tax in the hands of the investors on accrual basis. The Fund will continue to pay tax on income other than from VCUs (such as bank interest, income from mutual funds etc.) It is also noticed that the Assessee has filed the requisite Form No. 64 as per Rule 12C of the Income-tax Rules with the Commissioner of Income-tax 21, Mumbai, who had the jurisdiction over the Venture Capital Fund. The Assessee has also issued Form No.64 to respective investors of each of the Schemes. Accordingly, the contention of the Assessee is found to be correct and accepted and the entire income earned from the investments made in the Venture Capital Undertakings is to be subjected to tax in the hands of investors as per provisions of section 115JU of the Act."

30. Thus, we find that the Assessing Officer had made a detailed enquiry in the matter during the course of assessment proceedings. We, therefore, find that what the PCIT has done in his order under Section 263 of the Act dated August 10, 2018 is only to substitute her views in place of the views of the Assessing Officer. This is clearly contrary to the ruling of this Court in ***CIT v/s Gabriel India Limited (203 ITR 108)***. The detailed factual aspects of the matter have been discussed in the impugned order and set out hereinabove, with reference to the queries posed, details sought, and replies furnished, clearly establishing how the Assessing Officer has applied his mind to the facts of the present case. After applying his mind and considering the explanation given by the Assessee, the exemption was allowed by the Assessing Officer. We, therefore, find that the PCIT was

not justified in invoking the provisions of Section 263 by only substituting his views in place of the views of the Assessing Officer.

31. Further as held by the Apex Court in ***Malabar Industrial Co. Ltd. v. CIT [(2000) 243 ITR 83 (SC)]***, for exercising jurisdiction under Section 263 of the Act, both the conditions i.e. the assessment order being erroneous and being prejudicial to the interest of the revenue are required to be satisfied. In the facts of the present case, we find that even the condition of the assessment order being prejudicial to the interest of the revenue is not satisfied. The ITAT has noted that the Assessee has submitted statements in Form No.64 before the appropriate authority and there is no adverse observation by the concerned authority that the Assessee has violated the conditions of Section 115U of the Act. The ITAT has held that the disputed income has been subjected to tax, though, not in the hands of the VCF, but in the hands of the unit holders. Hence, we find that no prejudice is caused to the revenue as the income has already been subjected to tax in the hands of the unit holders.

32. Even otherwise, we are of the view that the assessment order cannot be said to be erroneous on the basis of the allegation made

by the PCIT. With respect to investment made by the Assessee in mutual funds, we note that SEBI has issued a clarification that temporary investments in mutual funds by the VCFs are permissible, and therefore, such investment cannot be said to be in violation of the SEBI VCF Regulations. With respect to investment in the real estate sector and entities in such sector being eligible to be considered as a VCU, the Tribunal has noted that the PCIT has relied on the AIF Regulations whereas the Assessee is governed by the VCF Regulations, and therefore, reliance on the AIF Regulations is not justified. Further, in so far as the VCF Regulations are concerned, the real estate sector has been removed from the Negative List under the Third Schedule of the VCF Regulations with effect from 5th April, 2004. Therefore, there is no violation of the VCF Regulations by investing in the real estate sector. Lastly, when the Assessee invested in the VCU, merely because the VCU was engaged in real estate activity, it cannot be stated that the Assessee is engaged in real estate activity as the Assessee is an entity separate from the VCUs. Further, in the absence of any allegation or action by SEBI against the Assessee for alleged violation of the SEBI VCF Regulations, the PCIT cannot make such allegations to deny exemption under the provisions of the Act.

33. Accordingly, we hold that the ITAT has rightly set aside the order passed by the PCIT under Section 263 of the Act as the jurisdictional requirement of Section 263 has not been satisfied in the present case. Thus, no substantial question of law arises from the order of the ITAT.

34. The Appeal is accordingly dismissed. There shall be no order as to cost.

35. This order will be digitally signed by the Private Secretary/ Personal Assistant of this Court. All concerned will act on production by fax or email of a digitally signed copy of this order.

[FIRDOSH P. POONIWALLA, J.]

[B. P. COLABA WALLA, J.]

Utkarsh