REPORTABLE

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No.270 of 2010**
with
ITA No.1345 of 2010

Reserved On: March 31, 2011.
% *Pronounced On: May 11, 2011.*

1) **ITA No.270 of 2010**

COMMISSIONER OF INCOME TAX . . . Appellant

through : Mr. Anupam Tripathi, Sr. Standing Counsel.

VERSUS

M/s. NALWA INVESTMENTS LTD. . . .Respondent

through: Mr. Ajay Vohra with Ms. Kavita Jha, Advocates.

2) **ITA No.1345 of 2010**

COMMISSIONER OF INCOME TAX . . . Appellant

through : Mr. Abhishek Maratha, Sr. Standing Counsel.

VERSUS

M/s. NALWA INVESTMENTS LTD. . . .Respondent

through: Mr. Ajay Vohra with Ms. Kavita Jha, Advocates.

CORAM :-
HON'BLE MR. JUSTICE A.K. SIKRI
HON'BLE MR. JUSTICE M.L. MEHTA

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?

2. To be referred to the Reporter or not?

3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

ITA No.270 of 2010

1. The assessment order passed by the Assessing Officer (AO) in respect of Assessment Year 2003-04 was tinkered with by the Commissioner of Income Tax (CIT) in exercise of its powers under Section 263 of the Income Tax Act (hereinafter referred to as 'the Act'). The CIT was of the opinion that the AO had not done his job properly while making the assessment inasmuch as in respect of certain items, the AO did not bestow any consideration or applied his mind leading to escapement of income. He, thus, restored the matter back to the file of AO for deciding the said issue afresh. This order of the CIT passed under Section 263 of the Act was successfully challenged by the assessee before the Income Tax Appellate Tribunal ('the Tribunal' for brevity), which has, by reason of impugned orders dated 26.03.2009, set aside the order of the CIT. It is this impugned order of the Tribunal, which is the subject matter of appeal No.270 of 2010 and has given rise to the following substantial question of law:

> Whether the Tribunal was justified in setting aside the orders of the CIT passed under Section 263 of the Income Tax Act on the purported ground that the view taken by

the Assessing Office in the scrutiny assessment was a plausible view?

2. We have accordingly heard the arguments on the aforesaid issue and proceed to decide the same. The issue which is involved in this appeal is limited to the treatment which has been given to the dividend income earned by the assessee in the relevant assessment year. Though it is treated as 'income from other sources', the dispute is as to whether the assessee is justified in claiming set off of brought forward losses of previous years against this dividend income giving it the character of 'business income' even though assessed as income from other sources. The moot question is as to whether the AO while allowing the aforesaid set off had considered this aspect or the CIT was justified in passing the orders under Section 263 of the Act on the premise that the issue was not appropriately dealt with by the AO. Before we deal with the nuances of this issue, it would be necessary to take note of the background under which the issue has cropped up.

3. The assessee is a non-banking company registered with the Reserve Bank of India and is engaged in the business of investment in shares, securities, other debt instruments and financing loans and providing guarantees. In the relevant assessment year, it had mentioned dividend income of ₹44,51,317/- which had been shown as business income. The

AO, however, found that in previous years, it was treated as income from other sources, instead of business income. He, thus, accorded the same treatment in this year as well holding it to be income from other sources under Section 56 of the Act. At the same time, while computing the income of the assessee, the AO allowed business losses of the earlier years to be set off against this dividend income as well.

4. On perusal of the assessment record, the Commissioner of Income Tax noticed that the AO had wrongly allowed the set off of the brought forward losses against this income, which was not the income from business but the income from other sources. He observed that the provisions for carry forward and set off of business are provided under Section 72(1) of the Act which provides that losses of business and profession can be carried forward and set off against the profit from business and profession in the subsequent year and cannot be set off against the subsequent incomes falling under the head 'Income from Other Sources'. He, thus, was of the opinion that allowing the set off of brought forward business loss to the extent of ₹44,51,317/- had resulted in the assessment which was erroneous and prejudicial to the interest of Revenue. Show cause notice was given to the assessee, who filed its reply contending that the assessee was engaged in the business of investment and was holding the shares of other companies of

the same group. Investment was meant for control and management of investee companies. The shares constituted the business asset of the company and dividend earned from such investment was in nature of 'business income' and this income was eligible for set off against the brought forward business losses. After considering this response, the order was passed restoring the matter back to the file of the AO for the following reasons:

> "7. I have considered the contention of the Assessee and also gone through the various judgments cited by the assessee. Ratio of the judgments is applicable to the cases where examination of the facts established that purchase of shares was with intention to keep them as stock-in-trade. In the cases where intention at the time of purchase of share was to make long-term investments, the ratio would not apply. **In the case of Assessee Company, the Assessing Officer has failed to examine this crucial aspect as to what the nature of investments on which dividend was earned**. As discussed in the preceding para, prima-facie, the investments were held as long-term investment and no part of the investment was considered stock-in-trade by the Assessee. Therefore, **the Assessing Officer had failed to conduct the required enquiry and also had failed in application of the provisions of Section 72 (1) of the I.T. Act**. This rendered order passed by the AO erroneous inasmuch as prejudicial to the interest of Revenue to that extent. In the case of M/s. Gee Vee Enterprises 99 ITR 375, the jurisdictional High Court has categorically held that failure of the Assessing Officer to conduct the required enquiry and accepting the statement of the assessee without due verification renders the order erroneous inasmuch as prejudicial to the interest of revenue.
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> In a more recent judgment rendered by the Allahabad High Court in the case of Jagdish Kumar Gulati Vs. CIT 269 ITR 71, the Hon'ble Court considering various judicial pronouncements passed earlier viz. Duggal & Co. 220 ITR 456 (Delhi) K.A. Ramaswami Chettial 220 ITR 657 (Mad.) etc. held that absence of proper enquiry in a matter renders an order erroneous

> as well as prejudicial to the interest of the revenue. In view of above, assessment order is held to be erroneous insofar as prejudicial to the interest of revenue to the extent of allowing set off of brought forward business losses against the dividend income without examination of facts and proper enquiries.
>
> In view of the above, the issue of determining the nature of investment and assesses ability of dividend income and its set off with the brought forward business losses is restored back to the file of AO for deciding the issue afresh."

5. The Tribunal while quashing the aforesaid order of the CIT examined the nature of the dividend income earned by the assessee and on application of certain case laws came to the conclusion that the said income could be treated as business income as dividend was earned from the shares and securities held in the other companies in the same group. The view of the AO was, therefore, a plausible view and it could not be said that the AO had not applied his mind. Relevant portion of the order of the Tribunal, which discussed this aspect is reproduced below:

> "The CIT has held that the assessment order is erroneous insofar as prejudicial to the interest f revenue to the extent of allowing set off of brought forward of business losses against the dividend income without examination of facts and proper enquiry. it is further noticed that the Hon'ble Supreme Court in the case of Distributors (Baroda Pvt., referred to supra has categorically held that the investment made by the assessee company in the shares in the managed company are essentially linked with its managing agency business. It is noticed that in the assessee's case also, the assessee company has invested in the shares of the group companies in which it was holding a management control. Thus, obviously the income there from could only be from its business of managing agency. The principle as laid down by the Hon'ble Supreme Court in the case of Distributors (Baroda),

> referred to supra though the decision is in relation to the Income-tax Act, 1922 would apply in all force in relation to the Income-tax Act, 1961. A principle laid down by the Hon'ble Supreme Court is to be followed and if this principle is applied to the facts of the present case, it is noticed that the view as taken by the AO in the scrutiny assessment is a plausible view. Further, it cannot be said that the AO has not applied his mind. This being so, we are of the view that the order of the CIT is bad in law insofar as the view taken by the AO is a plausible view. In the circumstances, the order of the CIT as passed u/s 263 on 07.03.2008 in the case of this assessee for AY 2003-04 is quashed."

6. The neat submission of the learned counsels for the Revenue is that the entire approach of the Tribunal was erroneous inasmuch as it discussed the matter from a wrong angle and thus, arrived at wrong conclusion. In this behalf, it was submitted that the AO had himself accepted the dividend income as income from other sources. However, without discussing as to whether it could assume the character of business income of the assessee, the AO allowed the set off of the carry forward business losses of previous year against this dividend income. No exercise was done by the AO as to whether such an income could be given the character of business income and therefore, the CIT was right in restoring the matter back to the AO.

7. Mr. Ajay Vohra, learned counsel appearing for the assessee, on the other hand, made a fervent plea that no doubt the income was to be assessed under the head 'Income from Other Sources', but at the same time for the purposes of set off, it

was permissible for the authorities to see the inherent character of the said income, which was business income. He referred to the following judgments in support of his arguments:

(i) ***Commissioner of Income Tax Vs. Chugandas & Co.*** **55 ITR 17 (SC);**

(ii) ***Commissioner of Income Tax Vs. Cocanada Radhaswami Bank Ltd.*** **57 ITR 306 (SC);**

(iii) ***Commissioner of Income Tax Vs. Excellent Commercial Enterprises and Investment Ltd.*** **282 ITR 423**

(iv) ***Commissioner of Income Tax Vs. Amalgamations (P) Limited*** **226 ITR 188 (SC)**

Mr. Vohra also invoked the principles of consistency and referred to certain judgments in support of his submission.

8. We have considered the rival submission. It is an admitted fact that the assessee is a non-banking finance company engaged in the business of investment in shares, securities, other debt instruments and financing loans and providing guarantees. The income of the assessee comprises of receipts from interest on loans and securities, professional income as well as dividend income and entire income was shown under the head 'Income from Business and Profession', by the assessee. The CIT observed that the balance sheet of the assessee company shows that all the investments in shares of bodies corporate

was grouped as long-term investment and no part of investment had been considered stock-in-trade and was not grouped as part of current assets. Section 14 of the Act stipulates different heads under which income is to be assessed. Dividend income is assessable under the head 'Income from other sources'. This is the mandate of Section 56 (2) of the Act which reads as under:

> **Section 56 (2):** In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes shall be chargeable to income-tax under the head "Income from other sources", namely :-
> (i) Dividends;
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> (ia) Income referred to in sub-clause (viii) of clause (24) of section 2;
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> (ib) Income referred to in sub-clause (ix) of clause (24) of section 2;
>
> (ic) Income referred to in sub-clause (x) of clause (24) of section 2, if such income is not chargeable to income-tax under the head "Profits and gains of business or profession";
>
> (id) Income by way of interest on securities, if the income is not chargeable to income-tax under the head "Profits and gains of business or profession";
>
> (ii) Income from machinery, plant or furniture belonging to the assessee and let on hire, if the income is not chargeable to income-tax under the head "Profits and gains of business or profession";
>
> (iii) Where an assessee lets on hire machinery, plant or furniture belonging to him and also buildings, and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income-tax under the head "Profits and gains of business or profession";
>
> (iv) Income referred to in sub-clause (xi) of clause (24) of section 2, if such income is not chargeable to income-tax under the head "Profits and gains of business or profession" or under the head "Salaries".

9. This position is not disputed. However, the argument of Mr. Vohra was that even if under the scheme of the Act, the dividend income is to be charged under the head 'Income from other sources', the character of that income could still be looked into and it could be treated as business income for the purpose of set off. Mr. Vohra is right to this extent.

10. In ***Chugandas & Co. (supra)***, the Supreme Court held that the heads of income were intended merely to indicate the classes of income. These heads do not exhaustively delimit sources from which income arises. Business income is broken up under different heads only for the purpose of computation of the total income. By that breaking up, the income does not cease to be the income of the business, the different heads of income being only the classification prescribed by the Income-tax Act for computation. This principle was repeated by the Supreme Court in ***Cocanada Radhaswami Bank Ltd. (supra)***. In that case, the facts situation was somewhat similar. The assessee had earned some interest income on the securities and the brought forward loss was sought to be set off against the income even computed under the head 'interest on securities'. The Court opined that the assessee was entitled to set off the loss brought forward against the entire income not only the income computed under the head 'business' but also the interest and securities in succeeding years. Following

observations in the said judgment give the rationale for permitting this course of action:

> "The scheme of the Income-tax Act is that income-tax is one tax. Section 6 of the Income-tax Act, 1922, classifies the taxable income under different heads for the purpose of computation of the net income of the assessee. Though, for the purpose of computation of the income, interest on securities is separately classified, income by way of interest from securities does not cease to be part of income from business if the securities are part of the trading assets. Whether a particular income is part of the income from a business falls to be decided not on the basis of the provisions of Section 6 but on commercial principles."

11. Thus, even if the interest on securities is separately classified, view was taken that the said income would not cease to be part of income from business if the securities are part of trading assets. Gujarat High Court in the case of ***Additional Commissioner of Income Tax Vs. Laxmi Agents P. Ltd.*, 125 ITR 227** followed the aforesaid principles and summed up the legal position in the following manner:

> "In is thus clear that even though an item of income falls under a specific head, in spite of the fact that that item is earned for the purpose of business, for purposes other than the computation of income, the commercial character of that income can be taken into account. In the case before us, the commercial character of that income becomes helpful to us in determining whether the borrowing on which the interest is paid was for the purposes of business. We therefore, conclude on the second question that the Tribunal was right in holding that though the income from dividend has to be assessed under a separate head, payment of interest by the assessee on amounts borrowed for purposes of investments must be allowed as business expenditure, and not as expenditure incurred for earning dividends. This, therefore, settles question No. 2."

12. It would, therefore, be immaterial as to under what head specified under Section 14 of the Act that the income is computed. Even when it is not computed under the head 'income from profession and business', the commercial character of that income could still be taken into account. If it is found that the particular income was derived from the business of the assessee, for the purposes of set off, it can be taken as business income. This Court in ***Excellent Commercial Enterprises and Investment Ltd. (supra)*** has concurred with the aforesaid view. In that case, the Court ruled as under:

> "Applying the above settled principles, the Income-tax Appellate Tribunal had affirmed a finding of the Income-tax Commissioner (Appeals) that the Company in the interest of its business and to earn additional profits arising from such stock-in-trade had invested its money which was earning dividends on shares held in stock-in-trade. This was thus and rightly so treated as income from business and not income from other sources. No distinctive features have been placed before us which could persuade the Court to take a view different than the one which has been taken in the above orders. Even otherwise, it would be a finding of fact based and referable to the records which were produced before the Income-tax Tribunal.
>
> Once it is held that the shares held by the assessed as a stock in trade and the income whether directly or incidentally for holding of such shares as stock-in-trade, would be business income then it cannot be said that the dividend income would fall as an income from other sources as contemplated under section 56 of the Act and that set off of under section 72 of the Act in subsequent year would not be permissible……."

13. So far so good. But the relevant question, which is the core one and led CIT to pass the order under Section 263, of the Act is as to whether the AO applied his mind to the issue as to whether the dividend income could be given the character of business income for the purpose of set off. We have already taken note of the order of the AO. He recorded that even a dividend income in question was shown as business income by the assessee. The AO did not agree with the same, as in the previous years this income was shown as dividend income. After saying so, the AO straightaway allowed the set off of this income against the carry forward losses. The assessment order is totally silent and there is no discussion as to how this dividend income was to be given the character of business income for the purpose of set off under Section 72 of the Act. It was for this reason that the CIT held that the AO had not conducted any inquiry. The Tribunal, instead of appreciating these facts, went into the merits of the issue which the AO is supposed to deal with. It addressed the question as to whether dividend income could be given the character of business income and then observed that the view taken by the AO was plausible without appreciating that the AO had not even taken any view on this issue, it could not be said that the AO had not applied his mind. The entire reading of the assessment order clearly demonstrates that no such view is taken at all by the AO

on this aspect. It is intriguing, in the circumstances, as to from where the Tribunal came to the conclusion that the view taken by the AO was plausible or that the AO had applied his mind.

14. The Tribunal failed to appreciate the limited scope of appeal before it, viz., the validity of the order passed by the CIT exercising his revisionary power under Section 263 of the Act. Order of the CIT clearly revealed that he had applied his mind on the relevant aspect and had rightly noticed that the character of the said income was not investigated by the AO. This is highlighted by the CIT in Para 7 of the order passed by him, which is already extracted above. Therein, the CIT recorded that the Assessing Officer had failed to conduct the required enquiry and also had failed in application of the provisions of Section 72 (1) of the I.T. Act. This rendered order passed by the AO erroneous and prejudicial to the interest of Revenue to that extent. The Tribunal was, thus, supposed to adjudge the validity of such an order and not to go beyond when the challenge before it was limited to the said order passed by CIT in exercising the powers under Section 263 of the Act.

15. Mr. Ajay Vohra, learned counsel appearing for the assessee argued that when the view taken by the AO was plausible one, it was not proper for the CIT in exercise of his revisionary jurisdiction to interfere with that order and referred to the

judgment of the Punjab and Haryana High Court in the case of ***Commissioner of Income Tax Vs. Max India Ltd.*** **268 ITR 128** which is approved by the Supreme Court in the case of ***Commissioner of Income Tax Vs. Max India Ltd.*** **295 ITR 282**. However, this argument based on the aforesaid judgment is of no avail in the facts of the present case when it is found that the AO had not examined the issue at all and therefore, question of there being a plausible view does not arise.

16. We, thus, answer the question formulated above, in favour of the Revenue and against the assessee, as a result, the impugned order passed by the Tribunal is set aside.

17. However, there shall not be order as to costs.

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18. Insofar as this appeal is concerned, after the CIT had passed the order under Section 263 of the Act, the AO in order to give effect to the same, passed order dated 30.07.2008 under Section 143(3)/263 of the Act. This order was challenged by the assessee before the CIT (A). Since the Tribunal had quashed the order of CIT under Section 263 of the Act vide decision dated 26.03.2009, as a consequence, following that order, the CIT (A) allowed the appeal of the assessee vide orders dated 22.06.2009 setting aside the aforesaid order of the AO, which order has been confirmed by the Tribunal vide

impugned order dated 02.02.2010. As order of the CIT dated 07.03.2008 passed under Section 263 of the Act is restored, the impugned order dated 22.06.2009 and order dated 02.02.2010 passed by the CIT (A) and the AO are set aside and the matter is restored to the file of the CIT (A) to decide the appeal of the assessee on merits insofar as challenge of the assessee to orders dated 30.07.2008 passed by the AO under Section 143(3)/263 of the Act is concerned.

19. Appeals are disposed of in the aforesaid terms.

(A.K. SIKRI)
JUDGE

(M.L. MEHTA)
JUDGE

MAY 11, 2011
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