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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
16.
\+ **ITA 749/2014**

CHEMINVEST LIMITED ..... Appellant

Through: Mr Ajay Vohra, Senior Advocate with Ms. Kavita Jha and Mr. Vaibhav Kulkarni, Advocate.

versus

COMMISSIONER OF INCOME TAX-VI ..... Respondent

Through: Ms Suruchi Aggarwal, Senior Standing Counsel with Ms. Lakshmi Gurung, Advocate.

CORAM:
HON'BLE DR. JUSTICE S. MURALIDHAR
HON'BLE MR. JUSTICE VIBHU BAKHRU

O R D E R
% 02.09.2015

1. This is an appeal filed by the Assessee under Section 260A of the Income Tax Act, 1961 ('Act') against the order dated 4th January, 2013 passed by the Income Tax Appellate Tribunal (' ITAT') in ITA No.87/DEL/2008 for the Assessment Year ('AY') 2004-05.

2. **Admit**.

3. The following substantial question of law is arises for determination:

"Whether disallowance under Section 14A of the Act can be made in

a year in which no exempt income has been earned or received by the Assessee?"

4. The Appellant is engaged in the business of making investment in shares and accepting/granting of loans. The Assessee is one of the co-promoters of Max India Ltd.

5. In the AY in question, the Appellant borrowed funds on which interest expenditure of Rs.1,21,03,367/- was incurred. The factual assertion of the Appellant, which has not been controverted, is that in the relevant AY no dividend income was earned by the Appellant from the amount invested in various shares. For the AY in question, the Appellant filed a return of income declaring a loss of Rs.13,84,086/-. This case was picked up for scrutiny and the Assessing Officer (AO) completed the assessment under Section 143(3) of the Act disallowing Rs.97,87,570/- out of the total expenditure incurred during the year under Section 14A of the Act. The reason recorded by the AO for this disallowance was that the borrowed funds were utilized for the purpose of purchase of shares for the purpose to earn dividend income which is exempted under section 10(33) of the Act and thus, not forming a part of the total income, and therefore the interest

paid thereon had to be disallowed under Section 14A.

6. It may be mentioned at this stage that the Assessee has made a distinction between investments in unquoted shares, which was in the sum of Rs.4,16,155/-, and investments in shares (other than trade) on long term basis to the extent of Rs.6,88,70,000/-. Based on the aforementioned distinction, the AO in the assessment order dated 28th December, 2006, computed the disallowance as Rs.97,87,570/- being the interest paid on borrowed funds invested in long terms shares.

7. Mr. Ajay Vohra, learned Senior counsel appearing for the Assessee, produced the balance sheet and profit and loss account as well as the computation of income prepared by the Assessee for the AY in question i.e. 2004-05. In the balance sheet, it is seen that the investment in quoted shares of Max India Limited is shown under the head 'quoted-other than trade-long term'. An investment of approximately Rs.2,13,38,698 over the previous year has been made in the shares of Max India Ltd. It is also seen that the investments in other investment companies to the extent of Rs.4,61,155 is shown under the sub-head 'unquoted-trade-long term'. This figure has remained unchanged over the previous year. In the computation filed for the

purposes of the income tax return, the details of investments have been shown in two broad categories of 'capital assets' and 'trading assets' and the investment in Max India Limited is under the head 'trading assets' with the investments in the investment companies shown under the head of 'capital assets'.

8. The AO appears to have proportionately disallowed, for the purposes of Section 14A of the Act, the interest attributable to the long term investment (other than trade) for the purposes of earning exempted income. Since the unsecured loan borrowed for the purpose was Rs.6,88,70,000 the disallowance of the amount under Section 14 A of the Act was calculated thus:

"1,21,03,367 x 6,88,70,000 = Rs. 97,87,570
8,51,65,000"

9. The CIT (A) by an order dated 27th September 2007 upheld the applicability of Section 14A of the Act but agreed with the contention of the Appellant that only the net interest amount debited in the profit and loss account was required to be proportionately disallowed under Section 14A of the Act.

10. In the appeals filed both by the Revenue and the Assessee before the ITAT, a Special Bench was constituted to decide the question regarding applicability of Section 14A of the Act in an year when no exempt income had been earned. The Special Bench by an order dated 5th August 2009 answered the question by *inter alia* referring to the decision of the Supreme Court in ***CIT v. Rajendra Prasad Moody [1978] 115 ITR 519 (SC)***. The reasoning of the Special Bench was as under:

> "22. The controversy raised in this case is that the assessee had not earned or received any dividend in the year under consideration and, therefore, no disallowance can be made by invoking the provisions of Section 14A of the Act. We do not find any force in this contention of the assessee. When the expenditure of interest is incurred in relation to income which does not form part of total income, it has to suffer the disallowance irrespective of the fact whether any income is earned by the assessee or not. Section 14A does not envisage any such exception. This is even if the interest paid on borrowings for the purchase of share were allowable u/s 57 as an expenditure incurred for earning or making income as held by the Supreme Court in the case of *Rajendra Prasad Moody* (*supra*) or u/s 36 (l)(iii) as an expenditure incurred wholly and exclusively for the purposes of business as held by various decisions right from beginning of the Income Tax Act. When, prior to introduction of section 14A, an

expenditure both u/s 36 and 57 was allowable to an assessee without such requirement of earning or receipt of income, we cannot import any such condition when it comes for disallowance of the same expenditure u/s 14A of the Act. This is what is held by the Ahmedabad Bench of the Tribunal in the case of *Harish Krishnakant Bhat* (*supra*) when it observed that interest on monies borrowed for purchase of shares held as investment is not allowable whether or not there is any yield of dividend. It is so held by applying the decision of the Supreme Court in *Rajendra Prasad Moody* (*supra*) in the reverse case wherein it is that irrespective of dividend receipt, expenditure has to be allowed. Now since dividend is exempt, as a consequence thereof expenditure has to be disallowed."

11. The Special Bench of the ITAT negatived the submission of the Appellant that the language of both Sections 57 (iii) and Section 14A of the Act were materially different. The Appellant's further contention and that since the decision in ***Rajendra Prasad Moody*** (*supra*) was only in the context of purchase of shares in which case a deduction of expenses can be claimed under Section 57(iii) of the Act whereas in the present case the Assessee was entitled to deduction of expenses under Section 36(1)(iii) of the Act and, therefore, Section 14A cannot be applied, was also rejected.

12. The matter was then placed before the regular Bench of the ITAT which

passed the impugned order on 4th January 2013 remanding the matter to the file of the AO for reconsideration of the issue afresh. The ITAT referred to the decision of this Court in ***Maxopp Investment Ltd. v. Commissioner of Income-tax, New Delhi (2012) 347 ITR 272 (Del)***.

13. At the hearing of this case on 6th July 2015, the Court had asked the parties to also address the issue of whether the interest paid on borrowings for the purposes of investment by the Assessee could be treated as business expenditure?

14. Mr. Vohra has placed before the Court a large number of decisions including the decision of this Court in ***Eicher Goodearth Ltd. v. Commissioner of Income-tax [2015] 60 taxmann.com 268 (Delhi)*** which answered the question in the affirmative. Mr. Vohra has also placed reliance on decisions of the Supreme Court in ***CIT v. Chugandas & Co. [1964] 55 ITR 17 (SC)*** and ***CIT v. Cocanada Radhaswami Bank Ltd. [1965] 57 ITR 306 (SC)*** which hold that where shares were held as business investment, the dividend income though assessable to tax under the head 'income from other sources,' would retain its character as business income for all intents and purposes. In the latter decision it was specifically held that the income from

securities which forms part of the Assessee's trading assets or part of its income in business if loss incurs in business would be set off against that income in succeeding years. Mr. Vohra pointed out that even in the Assessee's case the business loss of previous year has been set off against the income of the subsequent years.

15. Turning to the central question that arises for consideration, the Court finds that the complete answer is provided by the decision of this Court in ***CIT v. Holcim India (P) Ltd.*** (decision dated 5th September 2014 in ITA No. 486/2014). In that case a similar question arose, viz., whether the ITAT was justified in deleting the disallowance under Section 14A of the Act when no dividend income had been earned by the Assessee in the relevant AY? The Court referred to the decision of this Court in ***Maxopp Investment Ltd.*** (*supra*) and to the decision of the Special Bench of the ITAT in this very case i.e. ***Cheminvest Ltd. v. CIT (2009) 317 ITR 86***. The Court also referred to three decisions of different High Courts which have decided the issue against Revenue. The first was the decision in ***Commissioner of Income Tax, Faridabad v. M/s. Lakhani Marketing Incl.*** (decision dated 2nd April 2014 of the High Court of Punjab and Haryana in ITA No. 970/2008) which in turn referred to two earlier decisions of the same Court

in ***CIT v. Hero Cycles Limited [2010] 323 ITR 518*** and ***CIT v. Winsome Textile Industries Ltd. [2009] 319 ITR 204***. The second was of the Gujarat High Court in ***Commissioner of Income Tax-I v. Corrtech Energy (P) Ltd. [2014] 223 Taxmann 130 (Guj.)*** and the third of the Allahabad High Court in ***Commissioner of Income Tax, Kanpur v. Shivam Motors (P) Ltd.*** (decision dated 5th May 2014 in ITA No. 88/2014). These three decisions reiterated the position that when an Assessee had not earned any taxable income in the relevant AY in question "corresponding expenditure could not be worked out for disallowance."

16. In ***CIT v. Holcim India (P) Ltd.*** (*supra*), the Court further explained as under:

> "15. Income exempt under Section 10 in a particular assessment year, may not have been exempt earlier and can become taxable in future years. Further, whether income earned in a subsequent year would or would not be taxable, may depend upon the nature of transaction entered into in the subsequent assessment year. For example, long term capital gain on sale of shares is presently not taxable where security transaction tax has been paid, but a private sale of shares in an off market transaction attracts capital gains tax. It is an undisputed position that respondent assessee is an

> investment company and had invested by purchasing a substantial number of shares and thereby securing right to management. Possibility of sale of shares by private placement etc. cannot be ruled out and is not an improbability. Dividend may or may not be declared. Dividend is declared by the company and strictly in legal sense, a shareholder has no control and cannot insist on payment of dividend. When declared, it is subjected to dividend distribution tax."

17. On facts, it was noticed in ***CIT v. Holcim India (P) Ltd.*** (*supra*) that the Revenue had accepted the genuineness of the expenditure incurred by the Assessee in that case and that expenditure had been incurred to protect investment made.

18. In the present case, the factual position that has not been disputed is that the investment by the Assessee in the shares of Max India Ltd. is in the form of a strategic investment. Since the business of the Assessee is of holding investments, the interest expenditure must be held to have been incurred for holding and maintaining such investment. The interest expenditure incurred by the Assessee is in relation to such investments which gives rise to income which does not form part of total income.

19. In light of the clear exposition of the law in ***Holcim India (P) Ltd.*** (*supra*) and in view of the admitted factual position in this case that the Assessee has made strategic investment in shares of Max India Ltd.; that no exempted income was earned by the Assessee in the relevant AY and since the genuineness of the expenditure incurred by the Assessee is not in doubt, the question framed is required to be answered in favour of the Assessee and against the Revenue.

20. Since the Special Bench has relied upon the decision of the Supreme Court in ***Rajendra Prasad Moody*** (*supra*), it is considered necessary to discuss the true purport of the said decision. It is noticed to begin with that the issue before the Supreme Court in the said case was whether the expenditure under Section 57 (iii) of the Act could be allowed as a deduction against dividend income assessable under the head "income from other sources". Under Section 57 (iii) of the Act deduction is allowed in respect of any expenditure laid out or expended wholly or exclusively for the purpose of making or earning such income. The Supreme Court explained that the expression "incurred for making or earning such income', did not mean that any income should in fact have been earned as a condition precedent for claiming the expenditure. The Court explained:

> "What s. 57(iii) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. It is the purpose of the expenditure that is relevant in determining the applicability of s. 57(iii) and that purpose must be making or earning of income. s. 57(iii) does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction. It does not say that the expenditure shall be deductible only if any income is made or earned. There is in fact nothing in the language of s. 57(iii) to suggest that the purpose for which the expenditure is made should fructify into any benefit by way of return in the shape of income. The plain natural construction of the language of s. 57(iii) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of the expenditure."

21. There is merit in the contention of Mr. Vohra that the decision of the Supreme Court in ***Rajendra Prasad Moody*** (*supra*) was rendered in the context of allowability of deduction under Section 57(iii) of the Act, where the expression used is 'for the purpose of making or earning such income'. Section 14A of the Act on the other hand contains the expression 'in relation to income which does not form part of the total income.' The decision in ***Rajendra Prasad Moody*** (*supra*) cannot be used in the reverse to contend that even if no income has been received, the expenditure incurred can be disallowed under Section 14A of the Act.

22. In the impugned order, the ITAT has referred to the decision in ***Maxopp***

Investment Ltd. (*supra*) and remanded the matter to the AO for reconsideration of the issue afresh. The issue in ***Maxopp Investment Ltd.*** (*supra*)was whether the expenditure (including interest on borrowed funds) in respect of investment in shares of operating companies for acquiring and retaining a controlling interest therein was disallowable under Section 14 A of the Act. In the said case admittedly there was dividend earned on such investment. In other words, it was not a case, as the present, where no exempt income was earned in the year in question. Consequently, the said decision was not relevant and did not apply in the context of the issue projected in the present case.

23. In the context of the facts enumerated hereinbefore the Court answers the question framed by holding that the expression 'does not form part of the total income' in Section 14A of the envisages that there should be an actual receipt of income, which is not includible in the total income, during the relevant previous year for the purpose of disallowing any expenditure incurred in relation to the said income. In other words, Section 14A will not apply if no exempt income is received or receivable during the relevant previous year.

24. Consequently, the impugned order of the ITAT is set aside and the appeal is allowed in the above terms. This Court should not be understood to have expressed any opinion on the issue of whether for the AY in question the interest expenditure incurred by the Assessee would be allowable as business expenditure under Section 36 (1)(iii) of the Act.

S. MURALIDHAR, J

VIBHU BAKHRU, J

SEPTEMBER 2, 2015
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