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

\+ **ITA 725/2018**

Date of decision: 22nd October, 2018

PR. COMMISSIONER OF INCOME TAX -6, NEW DELHI

..... Appellant

Through: Mr. Asheesh Jain, Sr. Standing Counsel for Income Tax Department with Mr. Sanjay Kumar and Mr. Dushyant Sarna, Advocates.

versus

MCDONALD'S INDIA PVT. LTD. ..... Respondent

Through: Ms. Kavita Jha and Ms. Devika Jain, Advocates.

ITA No. 5094/Del/2012
Assessment Year-2008-09

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

SANJIV KHANNA, J. (ORAL)

This appeal filed by the Revenue under Section 260A of the Income-Tax Act, 1961 ('Act' for short) in the case of McDonald's India Pvt. Ltd (the respondent-assessee, for short) relates to the assessment year 2008-09 and arises from the order of the Income-tax Appellate Tribunal (the Tribunal, for short) dated 28th November, 2017.

2. Revenue submits that the Tribunal has erred in deleting disallowance of Rs.1,64,44,211/- made by the Assessing officer under Section 14A of the Act on the ground the respondent-assessee had not earned any exempt income during the assessment year.

3. The Tribunal in the impugned order on the said aspect has observed:

> " 4. Having heard both the sides and perused the relevant material on record, we find that the legal position is no more *res integra* in view of the judgment of the Hon'ble jurisdictional High Court in the case *Cheminvest Ltd vs. CIT (2015) 378 ITR 33 (Del),* wherein it has been held that if there is no exempt income, there can be no question of making any disallowance u/s 14A. Similar view has been taken by the Hon'ble jurisdictional High Court in *CIT vs. Holcim India P. Ltd. (2014) 90CCH 081-Del-HC*. In view of these binding precedents providing for not making any disallowance u/s 14A in the absence of any exempt income, we hold in principle that no disallowance be made in case of Nil exempt income."

4. The impugned order and reasoning follows the judgment of the Delhi High Court in ***Cheminvest Ltd. Vs. Commissioner of Income-tax IV*** [2015] 378 ITR 33 (Delhi) and ***Commissioner of Income-tax –IV Vs. Holcim India Pvt. Ltd.*** (2014) 272 CTR 282 (Delhi). Similar view has been taken by several High Court including the Punjab & Haryana High Court in ***Commissioner of Income-tax, Faridabad Vs. Lakhani Inc.*** ITA No.970/2008 decided on 2nd April, 2014, the Gujarat High Court in ***Commissioner of Income Tax-I Vs. Corrtech Energy (P.) Ltd.*** [2014] 223

Taxmann 130 (Guj.) and the Allahabad High Court in Income Tax Appeal No.88/2014 ***Commissioner of Income Tax (Ii) Kanpur, Vs. M/s. Shivam Motors (P) Ltd.*** decided on 5th May, 2014 and the Madras High Court in ***Commissioner of Income-tax, Central 1, Chennai Vs. Chettinad Logistics (P) Ltd.*** (2017) 248 Taxman 55 (Madras).

5. Counsel for the Revenue referring to the decision of the Supreme Court in ***Maxopp Investment Ltd. Vs. Commissioner of Income tax***, (2018) 402 ITR 640 (SC) and an earlier judgment of the Supreme Court in ***Commissioner of Income-tax Vs. Walford Share & Stock Brokers Pvt. Ltd.*** (2010) 326 ITR 1 (SC) submits the ratio and view expressed in ***Cheminvest Ltd.*** (Supra) and ***Holcim India Pvt. Ltd.*** (Supra) has been overruled and at-least requires reconsideration.

6. We have considered the said judgments, but do not think that there is any ground or reason to not follow the clear and categorical ratio of the decisions of the Delhi High Court in ***Cheminvest Ltd. Vs. Commissioner of Income-tax*** (Supra) and ***Holcim India Pvt. Ltd*** (Supra).

7. In ***Walford Share & Stock Brokers Pvt. Ltd.*** (Supra) the assessee had purchased units at a higher price of Rs. 17.23 per unit on which tax-free dividend of Rs.4/- per unit was received. The units were sold after the record date at Rs.13.23 per unit incurring loss. Contention of the Revenue

was that the loss, i.e. difference between the purchase price and sale price of the units, was expenditure incurred for earning tax free dividend income and accordingly could be disallowed under Section 14A of the Act. This contention of the Revenue was rejected. In the context of the controversy, the Supreme Court had examined the legislative history and object and purpose behind insertion of Section 14A by Finance Act, 2001 with retrospective effect from 1st April, 1962 and the proviso to Section 14A by Finance Act, 2002 with retrospective effect from 11th May, 2001. One or two sentences that Section 14A clarifies that expenses incurred can be allowed only to the extent that they are relatable to earning of taxable income cannot be read out of context, for the Supreme Court in ***Walford Share & Stock Brokers Pvt. Ltd.*** (Supra) has emphatically held and observed that Section 14A would apply when an income does not form part of the total income. Then the related expenditure would not be allowed. This decision did not directly examine and answer the issue in question i.e. whether any disallowance under Section 14A can be made when the assessee has not earned any exempt income during the year in question.

8. The decision in the case of ***Maxopp Investment Ltd. (Supra)*** is significant and does answer the question in issue. This decision does not support the Revenue as the Assessing Officer in the case of ***Maxopp***

Investment Ltd. (Supra) had himself restricted the disallowance to the extent of exempt income. After referring to ***Walford Share and Stock Brokers P. Ltd.*** (Supra) it was held-

> "Axiomatically, it is that expenditure alone which has been incurred in relation to the income which is includable in total income that has to be disallowed. If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would obviously be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure. To put it differently, such expenditure would then be considered as incurred in respect of other income which is to be treated as part of the total income."

9. The position becomes clear and beyond doubt when we refer to the factual position in the appeal preferred by the Revenue against the decision of the Punjab and Haryana High Court in the case of ***Pr. Commissioner of Income Tax v. State Bank of Patiala*** reported (2017) 391 ITR 218 (P&H), which was also decided with the decision in ***Maxopp Investment Ltd*** (Supra). In ***State Bank of Patiala*** (Supra) the Assessing Officer had applied Rule 8D of the Income Tax Rules 1962, but had restricted the disallowance to the amount claimed as exempt income. The Commissioner of Income-tax (Appeals) had enhanced and increased this disallowance as per Rule 8D of the Income Tax Rules, 1962. The said disallowance was more than exempt income. The Tribunal had reversed the finding of the Commissioner of

Income-tax (Appeals) and restored the disallowance as made by the Assessing Officer i.e. restricted the disallowance to the extent of exempt income. Decision in the case of ***State Bank of Patiala*** of the Punjab and Haryana High Court was affirmed by the Supreme Court as the correct conclusion, though the Supreme Court did not agree with the reasoning of the Punjab & High Court on the theory of dominant intention. It was held that the view of the Commissioner of Income Tax (Appeals) disallowing expenditure beyond and above the exempt income earned by applying Rule 8D was clearly untenable and rightly rejected by the Tribunal.

10. The decision of the Delhi High Court in ***Holcim India Pvt. Ltd*** (Supra) had referred to the issue whether disallowance of expenditure under Section 14A of the Act would be made even when no exempt income in the form of dividend was earned in the year, and it was observed:

> "14. On the issue whether the respondent-assessee could have earned dividend income and even if no dividend income was earned, yet Section 14A can be invoked and disallowance of expenditure can be made, there are three decisions of the different High Courts directly on the issue and against the appellant-Revenue. No contrary decision of a High Court has been shown to us. The Punjab and Haryana High Court in Commissioner of Income Tax, Faridabad Vs. M/s. Lakhani Marketing Incl., ITA No. 970/2008, decided on 02.04.2014, made reference to two earlier decisions of the same Court in CIT Vs. Hero Cycles Limited, [2010] 323 ITR 518 and CIT Vs.

Winsome Textile Industries Limited, [2009] 319 ITR 204 to hold that Section 14A cannot be invoked when no exempt income was earned. The second decision is of the Gujarat High Court in Commissioner of Income Tax-I Vs. Corrtech Energy (P.) Ltd. [2014] 223 Taxmann 130 (Guj.). The third decision is of the Allahabad High Court in Income Tax Appeal No. 88 of 2014, Commissioner of Income Tax (Ii) Kanpur, Vs. M/s. Shivam Motors (P) Ltd. decided on 05.05.2014. In the said decision it has been held:

> "As regards the second question, Section 14A of the Act provides that for the purposes of computing the total income under the Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act. Hence, what Section 14A provides is that if there is any income which does not form part of the income under the Act, the expenditure which is incurred for earning the income is not an allowable deduction. For the year in question, the finding of fact is that the assessee had not earned any tax free income. Hence, in the absence of any tax free income, the corresponding expenditure could not be worked out for disallowance. The view of the CIT(A), which has been affirmed by the Tribunal, hence does not give rise to any substantial question of law. Hence, the deletion of the disallowance of Rs.2,03,752/- made by the Assessing Officer was in order" .

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."

11. Decision in ***Holcim India Pvt. Ltd*** (Supra) was followed and elaborated in ***Cheminvest Ltd.*** (Supra).

12. The Madras High Court judgment in ***Chettinad Logistics (P) Ltd.*** (Supra) has taken similar view following their earlier decision in ***M/s. Redington (India) Limited Vs. The Additional Commissioner of Income Tax*** [T.C.A. No.520/2016] decided on 23rd December, 2016. In ***M/s. Redington (India) Limited Vs. The Additional Commissioner of Income Tax*** (Supra) it was held:

> "4. The admitted position is that no exempt income has been earned by the assessee in the financial year relevant to the assessment year in issue. The order of assessment records a finding of fact to that effect. The issue to be decided thus lies within the short compass of whether a disallowance in terms of

section 14A of the Act read with Rule 8D of the Rules can be contemplated even in a situation where no exempt income has admittedly been earned by the assessee in the relevant financial year.

7. Per contra, Sri T. Ravikumar appearing on behalf of the revenue drew our attention to the marginal notes of s. 14A pointing out that the provision would apply not only where exempted income is 'included' in the total income, but also where exempt income is 'includable' in total income.

8. He relied upon a Circular issued by the Central Board of Direct taxes in Circular No. 5 of 2014 dated 11.2.2014 to the effect that section 14A was intended to cover even those situations whether there is a possibility of exempt income being earned in future. The Circular, at paragraph 4, states that it is not necessary for exempt income to have been included in the income of a particular year for the disallowance to be triggered. According to the Learned Standing Counsel, the provisions of section 14A are made applicable, in terms of sub-section (1) thereof to income 'under the act and not 'of the year' and a disallowance under section 14A r.w. Rule 8D can thus be effected even in a situation where a tax payer has not earned any taxable income in a particular year.

9. We are unable to subscribe to the aforesaid view. The provisions of section 14A were inserted as a response to the judgments of the Supreme Court in Commissioner of Income-tax v. Maharashtra Sugar Mills Limited [1971] 82 ITR 452 and Rajasthan State Warehousing Corporation v. Commissioner of Income-tax [2002] 242 ITR 450 in terms of which, expenditure incurred by an assessee carrying on a composite business giving rise to both taxable as well as non-taxable income, was allowable in entirety without apportionment. It was thus that section 14A was inserted providing that no deduction shall be

allowable in respect of expenditure incurred in relation to the earning of income exempt from taxation. As observed by the Supreme Court in the judgment in the case of Commissioner of Income-tax v. Walfort Share and Stock Brokers (P) Ltd. (2010) 326 ITR 1.

'.... The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of an exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income.'

10. The provision this is clearly relatable to the earning of actual income and not notional or anticipated income. The submission of the Department to the effect that section 14A would be attracted even to exempt income 'includable' in total income would entail the assessment of notional income, assumed to be exempt in the future, in the present assessment year. The computation of total income in terms of section 5 of the Act is on real income and there is no sanction in law for the assessment of admittedly notional income, particularly in the context of effecting a disallowance in connection therewith.

11. The computation of disallowance in terms of Rule 8D is by way of a determination involving direct as well as indirect attribution. Thus, accepting the submission of the Revenue would result in the imposition of an artificial method of computation on notional and assumed income. We believe this would be carrying the artifice too far.

(emphasis is ours)"

13. We have been informed that SLP preferred by the Department against the decision in ***Chettinad Logistics*** (Supra) has been dismissed. Counsel

appearing for the respondent-assessee has submitted that the Supreme Court while deciding the batch of appeals in ***Maxopp Investment Ltd.*** (Supra) had also heard arguments and decided SLP (Civil) No.27054/2016 arising from the judgment of the Gujarat High Court dated 16th February, 2016 in Tax Appeal No. 206/2016, ***Principal Commissioner of Income-tax (1) Vs. D.B. Corp Limited***. In this case the Gujarat High Court had refused to admit the appeal on proposed question no.2 - whether disallowance under Section 14A could be made when assessee during the particular assessment year had not earned any exempt income, observing that there was no infirmity in the approach adopted by the Tribunal warranting interference. The Tribunal had restored the matter to the file of the Assessing Officer to verify the claim of the assessee that it did not claim any income to be exempt from payment of income tax.

14. Our attention is also drawn to order dated 6th April, 2018 passed in Special Leave petition (Civil) No.37851/2017 in the case of ***DLF Hotels Holdings Limited***, by which the SLP preferred by the revenue was dismissed by the Supreme Court, observing that the issue was covered by the decision of the Supreme Court in its order dated 12th February, 2018 in the case of ***D.B. Corpn. Limted (Supra)***.

15. Be that as it may, in view of the ratio ***in Maxopp Investment Ltd., Holicim India P.Ltd***. (Supra) and ***Cheminvest Ltd.*** (Supra), we do not find any substantial question of law that arises for consideration.

16. The appeal is accordingly dismissed, with no order as to costs.

SANJIV KHANNA, J.

ANUP JAIRAM BHAMBHANI, J.

OCTOBER 22, 2018 MR/ssn