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

Date of Order: 26.03.2019

\+ ITA 1142/2018

\+ ITA 1144/2018

PRINCIPAL COMMISSIONER OF INCOME TAX-6 ..... Appellant

Through: Mr.Asheesh Jain, Sr.Std.Counsel with
Mr.Sanjay Kumar, Jr.Std.Counsel

versus

NALWA SONS INVESTMENT LTD. ..... Respondent

Through: Mr.Ajay Vohra, Sr.Advocate with
Ms.Kavita Jha, Ms.Devika Jain &
Mr.Anant Mann, Advocates

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE PRATEEK JALAN

O R D E R

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S. RAVINDRA BHAT, (Open Court)

1. These two appeals are preferred by the revenue under Section 260A of the Income Tax Act ("the Act" hereafter); they challenge an order of the Income Tax Appellate Tribunal ("ITAT") relating to two assessment years concerning the assessee-respondent.

2. In ITA 1142/2018, three questions of law are urged (i) with respect to the disallowance (under Section 14A) directed to be deleted by the ITAT; (ii) the write-off of principal amount of bad debts, which had been initially disallowed by the assessing officer (AO) and the Commissioner (Appeals) (hereafter "CIT (A)") but set aside by the ITAT; and (iii) the finding with respect to the speculative loss recorded by the CIT(A), which was set aside by the ITAT. The CIT(A) had substituted or rather modified the findings of the AO who had brought to tax the entire loss amount of Rs. 73,54,155/-.

3. In ITA 1144/2018, solitary question is with respect to the correctness of the ITAT's findings with regard to the disallowance under Section 14A.

4. The facts are that although the original entity i.e. Jindal Strips Ltd. was engaged in multifarious activities, pursuant to the de-merger and corporate restructuring process undertaken in 2004-2005, the assessee, however, CONTINUED *with the principal objective of functioning as a non-banking financial institution*, i.e. advancing loans and engaging in investment activities. It reported a loss for assessment year (AY) 2005-06, to the tune of Rs. 73,54,155/-. The AO after due inquiry was of the opinion that this amount could not be allowed as loss and added it back under Section 68, holding transactions to be suspect.

5. The CIT(A) upon being approached in appeal, granted relief but the Appellate Commissioner, however, held that though the veracity of the transactions stood established, the assessee, had indulged in speculative transactions and therefore, on operation of explanation to Section 73, it is disentitled to the loss, and was rather entitled to set-off the speculative loss against the speculative profit. The ITAT, however, set aside the findings of the CIT(A) holding that the assessee did not fit the description but was in fact "excepted" from the operation of Explanation to Section 73.

6. The Revenue urges that ITAT's findings on this question are entirely erroneous and that the findings of the AO ought to be accepted. It was also urged that the ITAT fell into error in holding that there was no speculative loss; this argument was made on an

alternative basis.

7. At the outset, this Court notices that in the appeal preferred by the Revenue before the ITAT, the findings of the CIT(A) with respect to the veracity of the transaction were not challenged as is evident from the following extract:

> *"Since Ld.CIT(A) accepted the genuineness of the transactions of sale and purchase of shares in question and his findings have not been challenged by the Revenue in the Departmental appeal, therefore, we are of the view that the assessee would be entitled for deduction of loss. Thus, Ld.CIT(A) was unjustified to direct the AD to allow loss as speculation loss u/s 73 of the Act. We accordingly, set aside the orders of the authorities below and delete the entire addition. In the result, this ground of appeal of the assessee is allowed."*

8. For the above reasons, this Court is of the opinion that the Revenue's argument with respect to the applicability of Section 68, are unmerited.

9. As far as the findings of the CIT(A) regarding applicability of Section 73 are concerned, this Court is satisfied that textually the ITAT's findings were warranted. The relevant provision of Section 73 i.e. explanation to Section 73 reads as follows:

> *"Explanation – Where any part of the business of a company [other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources"], or a company [the principal business of which is the business of trading in shares of banking] or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such*

company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.]"

10. A plain reading of the explanation clarifies that where any part of the business of a company consists in the purchase and sale of shares of other companies, it is deemed to be carrying on a speculative business. In the present case, assessee falls within the exception carved out in the part of the section, which is found in the parenthesis (*"other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company [the principal business of which is the business of trading in shares of banking or the granting of loans and advances)*; its total income mainly consists of income derived from the granting of loans and advances. Such being the case, the CIT(A) clearly falls into error in holding that the loss reported pertains to a speculative transaction; the ITAT acted correctly in law in setting aside that finding. Therefore, no question of law arises in this aspect.

11. As to the second question [in ITA 1142/2018], which is write-off of the principal amount, this Court notices that the relief was granted on interest. The AO disallowed the interest. Interestingly, the assessee had not claimed write-off of the principal amount lent. In the appeal, the assessee urged certain additional grounds including claiming a write-off of bad debts. The CIT(A) did not allow this but on the other hand allowed the write-off of interest.

12. On further appeal to the ITAT, the assessee succeeded. The ITAT reasoned presumptively, that since the claim for interest had been allowed in the past and was even granted in the current assessment year, the assessee legitimately could claim the write-off as bad debts even towards the principal. For doing so, the ITAT relied upon the judgment of the Supreme Court in *T.R.F. Limited v. CIT, Ranchi* (2010) 323 ITR 397 (SC); as well as judgment of this Court in *CIT v. IFCI Venture Capital* (2009) 2 Taxmann.com 93 (Delhi). In the latter judgment, i.e. *IFCI Venture Capital* (supra), this Court held as follows:

> *"As per section 36(1)(vii), as amended with effect from 01.04.1989, the assessee is not required to establish that the concerned debt has actually become bad in the relevant year for the purpose of claiming deduction under the section and the only requirement for claiming this deduction is that the assessee has to write off the relevant debts in its books of accounts treating the same as bad.*
>
> *In the instant case, there was a finding of fact by the Tribunal that since the amount had been written off in the accounts, the assessee was no more required to prove whether the amount had become bad during the year or not. The write off was bonafide.*
>
> *Under the circumstances, the assessee was duly entitled for deduction of the sum on account of bad debts and there was no infirmity in the reasoning given by the Tribunal on that point and, as such, no substantial question of law arose for court's consideration and the revenue's appeal was not maintainable."*

13. As it is evident that the ITAT's decision was based upon the ruling of the Supreme Court and of this Court [especially *IFCI Venture Capital* (supra)], no question of law arises that the assessee in

the first instance did not claim the write-off as a deduction per se that does not stop it or preclude it from claiming relief, given the judgment of the Supreme Court in *Kedarnath Jute Mfg. Co. Ltd. v. CIT, (Central), Calcutta* (1971) 82 ITR 363 (SC). Furthermore, this Court is also of the opinion that Section 36(2) also applied to the facts and circumstances of this case.

14. On the last question urged by the Revenue i.e. disallowance under Section 14A, this Court notices that at the outset the period when the disallowance was to be calculated- in both appeals, was when there was no Rule 8D setting out the formula for calculating disallowance, under Section 14A(3). The assessee had claimed that it incurred no expenditure in earning dividend (i.e. tax exempt) income, which constituted approximately 40% of its income. The AO rejected its argument, and roughly apportioned about 9-10% of the exempt income, which bore some proportion to the tax exempt income: for instance, in AY 2005-06, the tax exempt income was Rs. 4.06 crores and the disallowance by the AO (and the CIT (A)) was Rs. 36,35,873/-; for AY 2006-07, the tax exempt income was Rs. 6.50 crores and the disallowance calculated was Rs. 72.62 lakhs.

15. The tribunal's reasoning for the first year, which prevailed in its analysis for the second year, is as follows:

> *".. 7. We have heard the rival submissions. It is not a dispute that Rule 8D is applicable from AY 2008-09. The assessee submitted before the AO that it has not incurred any expenditure for earning the dividend income. The AO has also noted in the assessment order that no interest element is involved on transaction. The assessee also submitted before the authorities below that investments*

were existing since 1998 and has come to the assessee upon demerger. The AO has not disputed the contention of the assessee. The AO should have considered the explanation of the assessee in proper prospective as regards the other expenditure also on which the assessee claimed that same were not incurred for earning any dividend income….

In the case of CIT vs Abhishek Industries Ltd. [2016] 380ITR 652 (P&H) by the Punjab & Haryana High Court held as under:-

> *"Section 14A of the Income-tax Act, 1961, empowers an Assessing Officer to disallow expenditure in relation to exempted income from shares if interest bearing funds have been used by the assessee. Section 14A may only be invoked if the assessee has made investments in purchase of shares out of borrowed funds. As a consequence, if the assessee has invested his own money in purchase of shares, there is no question of disallowance under section 14A. Section 14A requires the Assessing Officer to record satisfaction that interest bearing funds have been used to earn tax-free income. The satisfaction to be recorded must be based upon credible and relevant evidence. The onus, therefore, to prove that interest bearing funds were used, lies squarely on the shoulders of the Revenue. Thus, if the Assessing Officer is able to refer to relevant material while recording satisfaction that borrowed funds were used to earn interest-free income as opposed to the assessee's own funds, the Assessing Officer may legitimately disallow such a claim. The Assessing Officer, however, cannot, by recording general observations, particularly where the assessee has denied using interest bearing funds, proceeds to infer that interest-bearing income must have been used to earn exempted income. Section 14A, being in the nature of an exception must be construed strictly and only*

where the assessing officer records satisfaction, on the basis of clear and cogent material, shall an order be passed under section 14A disallowing such a claim. The assessee made a categorical submission of fact before the Assessing Officer that no interest bearing funds had been diverted to make investments leading to tax exempt income. The Assessing Officer, under section 14A read with rule 3D of the Income-tax Rules, 1962, disallowed expenditure in respect of the dividend earned by the assessee holding that interest bearings funds had been used to earn tax-free dividend. The Commissioner (Appeals) held that the Revenue had not been able to prove that interest bearing funds were used. This was confirmed by the Tribunal holding that as the Assessing Officer had failed to prove that interest bearing funds were used, it would not invite disallowance under section 14A. On appeal: Held, dismissing the appeal, that as there was no tangible material on record that could have enabled the Assessing Officer to record satisfaction in terms of section 14A the findings recorded by the Commissioner (Appeals) and the Tribunal that the Assessing Officer had failed to discharge this onus were neither perverse nor arbitrary and, therefore, did not call for interference."

8. Considering the facts of the case and in the absence of any satisfaction recorded by the AO, no disallowance should have been made by the authorities below. The assessee claimed that no expenses have been incurred for earning dividend income and investments were existing since 1998 and further admittedly no interest element is involved to earn dividend income would show that no borrowed funds have been used for making investment. If AO was not satisfied with the explanation of the assessee, he should have brought some material on record to disbelieve the explanation of the assessee. He should record his satisfaction as to how the

explanation of the assessee was unreasonable and unsatisfactory. In the absence of any evidence on record, disallowance made by the AO is not sustainable. We, accordingly, set aside the orders of the authorities below and delete the addition. This ground of appeal of the assessee is allowed."

16. Apparently, during the year (AY 2005-06), the total expenditure incurred was about Rs. 90 lakhs. During the hearing, the break-up of these expenses was revealed: about Rs. 2.5 lakhs was spent on salaries; the rest was on professional fees (including legal fees) transport, maintenance of vehicles, stationery, postage, printing etc. It was within the power of the AO to have inquired into these items, to scientifically apportion amounts attributable to expenditure that could reasonably bear proximity with earning of tax exempt income; instead, the AO merely rested content with applying a proportion, which was not appropriate. Given that the funds and scrips (which yielded dividend) were legacy assets, the assessee's arguments were reasonable.

17. For the above reasons, in both assessment years, the question relating to disallowance under Section 14A does not arise.

18. As a result of the above discussion, no substantial question of law arises for consideration. The appeals are, therefore, dismissed.

S. RAVINDRA BHAT, J

PRATEEK JALAN, J

MARCH 26, 2019
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