IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 02.08.2021

CORAM :

The Honourable Mr.Justice T.S.SIVAGNANAM
and
The Honourable Mr.Justice SATHI KUMAR SUKUMARA KURUP

T.C.A.No.421 of 2012

The Commissioner of Income Tax,
Chennai. .. Appellant

-vs-

M/s.Accel Limited,
3rd Floor, 75-Nelson Manickam Road,
Aminjikarai, Chennai-600 029. .. Respondent

Appeal under Section 260A of the Income Tax Act, 1961 against the order dated 10.07.2012 made in I.T.A.No.906(Mds)/2012 on the file of the Income Tax Appellate Tribunal 'D' Bench, Chennai for the assessment year 2002-03.

For Appellant : Mr.T.Ravikumar,
Senior Standing Counsel

For Respondent : Mr.R.Sivaraman

******

JUDGMENT

(Delivered by T.S.Sivagnanam, J.)

This appeal, by the Revenue, filed under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), is directed against the order dated 10.07.2012, made in I.T.A.No.906(Mds)/2012 on the file of the Income Tax Appellate Tribunal 'D' Bench, Chennai (for brevity "the Tribunal) for the assessment year 2002-03.

2.The tax case appeal was admitted on 30.11.2012 on the following substantial questions of law:-

> "1.Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in setting aside the Revision order passed u/s.263 of the Income Tax Act, 1961? and
>
> 2.Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the disallowance made under Section 14A was not applicable to the Assessment Year 2002-03 as

the same was brought into the statute book by Finance Act, 2006 with effect from 01.04.2007?"

3.The assessee filed its return of income disclosing a loss and the return was processed under Section 143(1) of the Act and was accepted. Subsequently, during the scrutiny proceedings, it was observed that the assessee had received a loan amounting to Rs.3 Crores from M/s.Accel ICIM, a company in which, the assessee holds more than 10% of the shares carrying voting rights. The Assessing Officer was of the view that in terms of the provisions of Section 2(22)(e) of the Act, any loan or advance received from a company in which, the assessee holds more than 10% of the shares with voting powers, shall be deemed to be a dividend taxable under the Act. For such reason, notice under Section 148 of the Act dated 28.01.2009 was issued. The assessee objected to the reopening of the assessment. The objections were disposed of by order dated 23.07.2009 stating that only during the remand proceedings, when the ledger account was examined, it came to the knowledge of the Assessing Officer that a sum of Rs.3 Crores has been actually received by the assessee from their subsidiary company in the year relevant to the assessment year 2002-03.

Therefore, the reassessment is valid. Further, it was pointed out that during the course of scrutiny assessment, it appeared in the books of the assessee that they have received a loan of Rs.3 Crores from its subsidiary company. The Assessing Officer discussed various aspects and completed the assessment vide order dated 18.11.2009.

4.The Commissioner of Income Tax, Chennai-I (for brevity, "the CIT") on perusal of the assessment order dated 18.11.2009, observed that the assessee has received dividend to the tune of Rs.2,56,12,828/- and such income was claimed to be exempt under Section 10(33) of the Act and as per the provisions of Section 14A of the Act, no deduction is allowable in respect of expenditure incurred in relation to income, which does not form part of the total income. Further, the assessee did not disallow any expenditure in relation to earning of such exempt dividend income while computing taxable income and this aspect has not been examined by the Assessing Officer and the failure has resulted in allowance of deduction of expenditure, which was otherwise not allowable under Section 14A of the Act. Therefore, the CIT was of the *prima facie* view that the assessment

was erroneous, insofar as it is prejudicial to the interest of the Revenue and notice under Section 263 of the Act was issued.

5.The assessee responded to the proceedings by contending that the M/s.Accel Frontline Limited was their subsidiary company, no bank charges were debited/involved in respect of the dividend receipt and Section 14A permits disallowance of expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act and since no expenditure was incurred or claimed in the return, in relation to the dividend income, there was no question of disallowance of any expenditure.

6.The issue relating to the computation of limitation for initiating proceedings under Section 263 was also raised by the assessee. The CIT by order dated 19.03.2012, rejected the stand taken by the assessee holding that the assessee received dividend and the entire income was claimed as exempt under Section 10(33) of the Act and they did not admit any expenditure relating to the said receipt and as per the provisions of Section 14A, no deduction is permissible in respect of expenditure in relation to exempt

income. Accordingly, the CIT held that the order of assessment was erroneous and prejudicial to the interest of Revenue.

7.With regard to the limitation issue, which was raised by the assessee, it was held that the contentions does not merit acceptance. Challenging the said order, the assessee had filed appeal before the Tribunal. So far as the issue relating to limitation is concerned, it was decided against the assessee holding that the assessment order passed by the Assessing Officer under Section 143(3) read with Section 147 of the Act by itself is independently amenable to revisional jurisdiction of the CIT. Against such finding, the assessee is not on appeal before us.

8.The only issue is with regard to whether the disallowance made under Section 14A was justified and whether the CIT could have invoked the power under Section 263 of the Act

9.Mr.T.Ravikumar, learned Senior Standing Counsel appearing for the appellant submitted that the Tribunal has rendered an erroneous finding

by observing that Section 14A has been brought into statute book by Finance Act, 2006 with effect from 01.04.2007 ignoring the fact that it was inserted by Finance Act, 2001 with retrospective effect from 01.04.1962. This erroneous finding, in the submission of the learned counsel, is an erroneous conclusion arrived at by the Tribunal. In support of his contention, the learned counsel placed reliance on the decision of the Hon'ble Supreme Court in the case of ***Maxopp Investment Ltd. vs. CIT*** reported in ***(2018) 402 ITR 0640 (SC)*** and by referring to paragraph 32 of the judgment, it is submitted that as per Section 14A(1) of the Act, deduction of that expenditure is not to be allowed, which has been incurred by the assessee "in relation to income, which does not form part of the total income under the Act". It is that expenditure alone, which has been incurred in relation to the income, which is includible in total income that has to be disallowed and if an expenditure incurred has no capital 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 total income. Further, the learned counsel also referred to the findings recorded by the Hon'ble Supreme Court in paragraphs 33 and 34 of the judgment. Therefore, it is submitted that the Tribunal has committed a serious error in allowing the appeal filed by the assessee.

10.In reply, Mr.R.Sivaraman, learned counsel appearing for the assessee submitted that the effect of retrospective amendment of Section 14A read with Rule 8D is no longer *res integra* and has been settled by the Hon'ble Supreme Court in the case of ***CIT vs. Essar Teleholdings Ltd.*** reported in ***(2018) 401 ITR 445 (SC).*** It is further submitted that *de hors* the said issue, the Tribunal has also gone into the aspect as to whether the CIT without even recording any *prima facie* finding to make out a case that certain amount claimed by the assessee as deduction in its computation income *de facto* relating to the earning of tax-free income, held that reassessment could not have been made. Therefore, it is submitted both on the legal issue as well as on the exercise of the power of the CIT under Section 263 that, the Tribunal has rightly held in favour of the assessee.

11.We have elaborately heard the learned counsels for the parties and carefully perused the materials placed on record.

12.The undisputed fact being that Section 14A stood inserted by Finance Act, 2001 with retrospective effect from 01.04.1962. If such is the situation whether based on such insertion, would it be a case where the Assessing Officers could be entitled to reopen the assessment. The case on hand appears to be one such case because the notice under Section 148 was issued on 28.01.2009, presumably taking note of the fact that the insertion of Section 14A was made with retrospective effect from 01.04.1962. Identical issue was subject matter of consideration in the case of ***Essar Teleholdings Ltd.*** (supra). The question, which fell for consideration before the Hon'ble Supreme Court was whether sub-section (2) and sub-section (3) of Section 14A inserted with effect from 01.04.2007 will apply to all pending assessments? And whether Rule 8D is retrospectively applicable?

13.It is the submission of Mr.T.Ravikumar, learned Senior Standing Counsel that the substantial questions of law, raised by the Revenue in this appeal are nothing to do with sub-section (2) or sub-section (3) of Section 14A or with regard to Rule 8D, but only with regard to the finding of the Tribunal that Section 14A(1) came into the statute book by Finance Act, 2006 with effect from 01.04.2007.

14.Before we consider the said submission, we shall take note of the decision of the Hon'ble Supreme Court in ***Essar Teleholdings Ltd.*** (supra). It was argued by the Revenue that the provisions of Section 14A being clarificatory in nature and Rule 8D is a procedural provision, which provides only a machinery for the implementation of sub-sections (2) and (3), Rule 8D is retrospective in nature. Further, it was submitted that the machinery provisions by which the charging section is to be implemented or workable are to be given retrospective effect which is co-terminus with the period of operation of the main charging provision. It was further submitted that the charging Section, i.e., Section 14A admittedly being retrospective,

the machinery provision, i.e., Rule 8D has also to be retrospective. Answering the said submission was not accepted by the Hon'ble Supreme Court and while answering the said issue, it was held as follows:-

> *"32. Explanatory memorandum issued with the Finance Bill, 2006 and the CBDT circular dated 28.12.2006, thus, clearly indicates that department understood that sub-section (2) and sub-section (3) was to be implemented with effect from assessment year 2007-2008. The Rule 8D prescribing the method was brought into statute book with effect from 24.03.2008 to implement sub-section (2) and sub-section (3) with effect from assessment year 2007-2008, is clear indicator of the fact that a new method for computing the expenditure was brought in by the rules which was to be utilized for computing expenditure for the Assessment Year 2007-2008 and onwards.*
>
> *33.When Section 14A was inserted by Finance Act, 2001, it was with retrospective effect with effect from 01.04.1962 where as Finance Act, 2006, by which sub-section (2) and sub-section (3) to Section 14A were inserted, it was with effect from 01.04.2006 which was mentioned in clause 1(2) of Finance Act, 2006 which was to the following effect:*

"1(2). Save as otherwise provided in this Act, Sections 2 to 57 shall be deemed to have come into force on the 1st day of April, 2006."

Rule 8D which was inserted by notification dated 24.03.2008. Rule 1 sub-rule (2) provides as under:

"1. (1) These rules may be called the Income-tax (Fifth Amendment) Rules, 2008.

(2). They shall come into force from date of their publication in the Official Gazette."

It is, however, well settled that the mere date of enforcement of statutory provisions does not conclude that the statute is prospective in nature. The nature and content of statute have to be looked into to find out the legislative scheme and the nature, effect and consequence of the statute."

15.The submission, which was pressed into service by the Revenue, was that Section 14A of the Act being clarificatory in nature having retrospective operation, Rule 8D, which is a machinery provision, has also to be held to be retrospective to make machinery provision workable. This submission was answered against the Revenue on the following terms:-

"35.It is to be noted that Section 14A was inserted

by Finance Act, 2001 and the provisions were fully workable without their being any mechanism provided for computing the expenditure. Although Section 14A was made effective from 01.04.1962 but Proviso was immediately inserted by Finance Act, 2002, providing that Section 14A shall not empower assessing officer either to reassess under Section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessees under Section 154, for any assessment year beginning on or before 01.04.2001. Thus, all concluded transactions prior to 01.04.2001 were made final and not allowed to be re-opened.

36.The memorandum of explanation explaining the provisions of Finance Act, 2006 has clearly mentioned that Section 14 sub-section (2) and sub-section (3) shall be effective with effect from the assessment year 2006-07 alone which is another indicator that provision was intended to operate prospectively."

16.Thus, a cumulative reading of the above decision will clearly show that the insertion of Section 14A with retrospective effect from 01.04.1962

is not with a view to reopen all concluded transactions prior to 01.04.2001 and the memorandum of explanation explaining the provisions of the Finance Act, 2006 has clearly mentioned that Section 14(2) and Section 14(3) shall be effective with effect from the assessment year 2006-07 alone, which is another indicator that the provision was intended to operate prospectively.

17.Bearing the above legal principles in mind, if we examine the order passed by the Tribunal, we find that the Tribunal has not committed an error in holding as if Section 14A(1) is operational with effect from 01.04.2007. In fact, on a reading of paragraph 7 of the impugned order passed by the Tribunal, one gets an impression that the Tribunal was of the view that the said provision is operational with effect from 01.04.2001. However, on a cumulative reading of the finding of the Tribunal in paragraph 7 in its entirety, we find that what was intended to be said by the Tribunal is that Section 14A of the Act has been functionally made operative on introduction of Rule 8D and the said Rule was inserted by Income-tax (Fifth Amendment) Rules, 2008 with effect from 24.03.2008

and therefore, Section 14A read with Rule 8D is not applicable to the impugned assessment year 2002-03. In this background, it was held that Section 14A(1) itself has been brought into the statute book by Finance Act, 2006 with effect from 01.04.2007. In fact, there appears to have been typographical error, since it should be Section 14A(2) and not Section 14A(1). Further, on a reading of paragraph 7, it is seen that the Tribunal has reiterated that the functional operation of Section 14A is not applicable to the assessment year, which was impugned before it. Thus, we find that the finding rendered by the Tribunal in paragraph 7 sets out the correct legal position. The Tribunal, not stopping with that, examined the scope of enquiry made by the CIT to examine as to whether the revision order is sustainable or not. On taking into consideration the factual position, the Tribunal held that general observations are not sufficient to hold an assessment order erroneous and prejudicial to the interests of the Revenue. It noted the submission of the assessee that dividend income has been received from its hundred per cent subsidiary and the assessee has not incurred any expenditure whatsoever in earning that dividend income and therefore, there was no occasion for the assessee to claim any such

expenditure in computing its taxable income. The Tribunal found fault with the CIT by observing that when such was the stand taken by the assessee, it is necessary for the CIT to at least record a *prima facie* finding that certain amount claimed by the assessee as deduction in its computation of income *de facto* related to earning of tax-free income. Thus, it was held that in the absence of any such *prima facie* finding, the reassessment was erroneous. Thus, we find that the Tribunal rightly held in favour of the assessee.

18.For all the above reasons, this tax case appeal, by the Revenue, stands dismissed and the substantial questions of law, framed for consideration, are answered against the Revenue. No costs.

(T.S.S., J.) (S.S.K., J.)
02.08.2021

Index: Yes/ No
Speaking Order : Yes/ No

abr

To

The Income Tax Appellate Tribunal 'D' Bench, Chennai.

T.S.Sivagnanam, J.
and
Sathi Kumar Sukumara Kurup, J.

(abr)

T.C.A.No.421 of 2012

02.08.2021