

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

+ **ITA 1260/2018**

Date of decision: 13th November, 2018

PR. COMMISSIONER OF INCOME TAX-2 Appellant
Through: Mr.Zoheb Hossain, St. Standing
Counsel with Ms.Sampurna Sanyal
and Mr.Piyush Goyal, Adv.

versus

M/S CARAF BUILDERS & CONSTRUCTIONS PVT. LTD.
..... Respondent
Through: Ms.Devika Jain, Adv.

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

SANJIV KHANNA, J. (ORAL)

CM No. 46986/2018 (seeking condonation of delay)

This is an application seeking condonation of 36 days delay in refiling the appeal. Learned counsel for the respondent-assessee has appeared on advance notice and does not oppose the application.

The application is accordingly allowed.

ITA 1260/2018

This appeal by the Revenue under Section 260A of the Income Tax

Act, 1961 (in short „the Act“) in the case of M/s. Caraf Builders & Construction Pvt. Ltd. ('respondent-assessee' for short) relates to the Assessment Year 2009-10 (in short „AY“) and arises from order of the Income Tax Appellate Tribunal (in short, 'the tribunal') dated 27.02.2018.

2. The only issue raised by the Revenue in this appeal relates to the quantum of disallowance under Section 14A of the Act. Hence, we need not refer to any other issue and aspect.
3. The respondent-assessee in the return for the year had declared income of Rs.6,30,950/- taxable under the head short-term capital gains earned from investment of Rs.38 crores in mutual funds units, which units were also sold/redeemed during the year.
4. Respondent-assessee had invested more than Rs.820 cores in equity shares of associated companies. No dividend income was earned on the equity shares. The shares were not sold or transferred.
5. Respondent-assessee had shown interest liability of Rs.153,08,66,463/- consisting of the following components:-

Interest on Term Loan	Rs.	131,47,42,466/-
Pre-payment and Other charges	Rs.	7,03,40,439
Interest on Debentures	Rs.	6,23,65,766/-
Interest to Others	Rs.	8,33,41,165/-
Total Interest Liability	Rs.	<u>153,08,66,463</u>

6. Respondent-assessee had earned and declared interest income of Rs.

41,61,57,245/- under the head „income from other sources. This interest had accrued or was paid by the subsidiaries to whom the respondent-assessee had granted loans and advances. The respondent- assessee did not earn and have any other taxable or non exempt income.

7. Respondent-assessee had incurred administrative expenditure of Rs.5,15,147/- and had paid Rs.25,34,548/- as fee and taxes for increase in the share capital.
8. Interest and administrative expenses incurred and paid being more than interest received, the respondent-assessee did not declare taxable income other than income from sale of mutual fund units taxable as short term capital gains
9. The respondent-assessee had earned dividend income of Rs.19,25,655/- on the investment made in the mutual funds. This dividend income was claimed as exempt income under Section 10 (34) of the Act.
10. The respondent-assessee had disallowed expenses of Rs.70,20,602/- under Section 14A of the Act as attributable to earning of the exempt income.
11. The Assessing Officer held that though the investment of Rs. 820 crores in equity shares had not yielded dividend income, this investment must be taken into consideration while computing disallowance under Section 14A of the Act for the provision prohibits allowance of any expenditure incurred in relation to exempt income which was not included in the total income by virtue of Section 10 of the Act. Dividend income earned on shares being exempt, disallowance has to be made on income in relation to earning of dividend on shares purchased.

Therefore, Rs.70,20,602/- disallowed by the respondent-assessee under Section 14A depicted an eschewed result.

12. Assessing Officer computed the disallowance under Section 14A of the Act by applying clauses (i), (ii) and (iii) of sub-rule (2) to Rule 8D of the Income Tax Rules, 1962 (in short, 'the Rules').
13. Under clause (i), 82% of the interest of Rs.153.08 crores paid on term loan, pre-payment and other charges, debentures and others, i.e. interest of Rs.113.57 crores, was disallowed as expenditure directly incurred for earning exempt income.
14. For computing disallowance under Clause (ii), balance interest of Rs.39.50 crores and average of total investment in the beginning and at the end of the year for the entire assets were considered. Computation under clause(ii) was not made with reference to the investment which had yielded exempt income. Accordingly, disallowance of Rs.27,55,00,000/- was made under clause (ii) of Rule 8D of the Rules.
15. Disallowance of Rs.4,09,00,000/- being 0.5% of the average investment was made under clause (iii) of Rule 8D (2) of the Rules. For computing disallowance under clause (iii) the average investments at the beginning and at the end of the year and not the investment yielding exempt income were taken as the basis.
16. The Assessing officer did not give benefit of setting of interest of Rs. 41.81 crores received by the respondent-assessee from the subsidiary companies.
17. Accordingly self disallowance of Rs. 70,20,602/- made by the respondent-assessee was enhanced and increased by Rs. 143,82,48,096/- to Rs.144,52,68,698/-.

18. Lastly, the Assessing Officer on the question of taxability of interest income of Rs.41,61,57,245/- observed that Rs.144,52,68,698/- had been disallowed under Section 14A leaving a balance sum of interest paid of Rs.8,55,97,765/-, which remained to be appropriated. Interest of Rs.8,55,97,765/- was set off against interest income of Rs.41,81,11,353/- and the taxable income, other than short term capital gains, was enhanced to Rs.33,31,99,690/-
19. The Commissioner of Income Tax (Appeals) reduced the disallowance to Rs.75,89,66,443.93 by accepting alternative computation made by the respondent-assessee. He noticed that interest expenditure was on account of borrowed funds from a bank, interest on debentures, interest paid to corporate bodies and subsidiaries. Interest bearing amount was invested in the shares of the subsidiary companies and for purchase of „Right Call Option“ and for making investment in mutual funds of Rs.38 crores, which had been redeemed during the year. On account of money advanced to the subsidiary companies, the respondent-assessee had received interest of Rs.41,81,11,353/-. Thus, there was direct and indirect connection between the borrowed funds and the amounts advanced. Interest received should be allowed to be set off from the interest paid to workout the disallowance. Therefore, for the purpose of computing disallowance under Section 14A, the amount of interest should be taken at Rs.111,27,55,110/-.
20. Commissioner of Income Tax (Appeals) held that in the absence of direct co-relation between the interest paid and investment in shares, no disallowance should be made under clause (i) of sub-rule (2) to Rule 8D of the Rules. The interest expenditure of Rs.111,27,55,110/- should be taken as an indirect expenditure for computing disallowance under clause (ii) to sub-rule (2) to Rule 8D of the Rules. Accordingly, indirect interest expenditure relating to investment in shares was computed at

Rs.75,84,51,296/-.

21. For the purpose of disallowance under clause (iii) to Rule 8D(2), the Commissioner of Income Tax (Appeals) held that the total administrative expenditure other than interest was Rs.5,15,147/- only, as Rs.25,34,548/- was paid towards fee and taxes for increase in the share capital of the respondent-assessee. Rs. 25,34,548/- was excluded for purpose of disallowance under clause (iii) of Rule 8D and the entire amount of Rs.5,15,147/- was disallowed.
22. Thus, the Commissioner of Income Tax (Appeals) had reduced the total disallowance made under Rule 8D to Rs.75,89,66,443/-.
23. By the impugned order, the Tribunal has upheld the computation of disallowance made by the Commissioner of Income Tax (Appeals).
24. The question of netting i.e. reduction of interest received from interest paid for the purpose of computation of disallowance under Rule 8D sub-rule (2) would in a given case require consideration. We would not express any firm or final opinion in this regard, as the question of quantum of deduction under Section 14A of the Act read with Rule 8D of the Rules is otherwise covered against the Revenue by decisions of the Supreme Court and this Court.
25. Total exempt income earned by the respondent-assessee in this year was Rs.19 lakhs. In these circumstances, we are not required to consider the case of the Revenue that the disallowance should be enhanced from Rs. 75.89 crores to Rs.144.52 crores. Upper disallowance as held in *Principal Commissioner of Income Tax vs. McDonalds India Pvt. Ltd., ITA 725/2018* decided on 22nd October, 2018 cannot exceed the exempt income of that year. This decision follows the ratio and

judgment of the Supreme Court in the case of *Maxopp Investments Ltd. vs. CIT (2018) 402 ITR 640 (SC)* and the earlier judgments of the Delhi High Court in *Cheminvest vs. CIT (2015) 378 ITR 33* and *CIT vs. Holcim Pvt. Ltd. (2014) 272 CTR (Del.) 282*. Relevant portion of the judgment in *McDonalds India Pvt.*

Ltd.(supra) reads:-

"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.”

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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. Corrttech 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). "
26. There is another error made by the Assessing Officer in computing the disallowance under clauses (ii) of Rule 8D (2) with reference to the formula prescribed. Numerical B in clause (ii) refers to average value of the investment, income from which does not form part or shall not form part of the total income. The Assessing Officer for numerical B in clause (ii) had taken the total value of the investment and not the investment that had yielded exempt income. The Delhi High Court in ITA No. 615/2014, *ACB India Ltd. vs. Asstt. Commissioner of Income Tax* decided on 24th March, 2015 has held that only average value of the entire investment that does not form part of the total income is the factor which could be covered by the numerical B for computing disallowance under clause (ii) of Rule 8D(2) of the Rules.
27. The appeal is accordingly dismissed without any order as to costs.

SANJIV KHANNA, J.

ANUP JAIRAM BHAMBHANI, J.

NOVEMBER 13, 2018 neelam