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

% *Date of Decision: 22.11.2023*

+ **ITA 163/2018**

THE PR. COMMISSIONER OF INCOME TAX -3 Appellant
Through: Mr Ruchir Bhatia, Sr Standing
Counsel with Ms Deeksha Gupta,
Adv.

versus

DEVATA TRADELINK LTD. Respondent
Through: Mr Gautam Jain with Mr Piyush
Kumar Kamal, Ms Monika Agarwal
and Mr Manish Yadav, Advs.

CORAM:

HON'BLE MR. JUSTICE RAJIV SHAKDHER
HON'BLE MR. JUSTICE GIRISH KATHPALIA

[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J.: (ORAL)

1. This appeal concerns Assessment Year (AY) 2008-09. *Via* the instant appeal, the appellant/revenue seeks to assail the order dated 15.06.2017 passed by the Income Tax Appellate Tribunal [in short, "Tribunal"].
2. What is not in dispute is that the Assessing Officer (AO) made an addition amounting to Rs.5,06,73,874/- under Section 14A of the Income Tax Act, 1961 [in short, "Act"] read with Rule 8D of the Income Tax Rules, 1962 [in short, "Rules"].
3. The Commissioner of Income Tax (Appeals) [in short, "CIT(A)"], *via* the order dated 09.07.2014 confirmed the addition made by the AO. In an appeal preferred by the respondent/assessee with the Tribunal, the



addition was deleted.

4. The facts that emerge from the record show that the respondent/assessee in the period in issue i.e., Financial Year (FY) 2007-08 [AY 2008-09] had earned exempt income amounting to Rs.35,347/-.

4.1 Against the said income, the respondent/assessee had made a suo motu disallowance amounting to Rs.87,442/-. The AO, however, added to the respondent's/assessee's income, as indicated above, Rs.5,06,73,874/- based on the following rationale contained in the order dated 03.11.2010:

“The language of subsection (1) of section 14A clearly provides that 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 this Act". On going through the simple and plain language, it is abundantly clear that the relation has to be seen between the exempt income and the expenditure incurred in relation to it and not vice versa. What is relevant is to work out the expenditure in relation to the exempt income and the expenditure incurred in relation to it and not vice versa. What is relevant whether the expenditure incurred by the assessee has resulted into exempt income or taxable income. From the three clauses of rule 8D it clearly emerges that stipulation of section is to compute the amount of expenditure which is not allowable u/s 14A as is relatable to the exempt income and not in considering all the expenses one by one for ascertaining if either of them have resulted into exempt income and thereafter considering such amount as disallowable u/s 14A. In above background apportionment of expenses is done applying section 14A read with Rule 8D as under:-

| Clause | Particulars | | | Amount |
|--------|---|-----|--|--------|
| i | Expenditure directly related to exempt income | Nil | | |



| | | | | |
|------------|--|---|---|---|
| | <i>Disallowance of interest expenditure</i> <i>A. Interest expenditure incurred during the year other than (i) above</i> <i>B. Average Value of Investment</i> <i>C. Average of total assets</i> <i>Disallowance = A * B/C</i> | <i>50,642,471</i> <i>119758172</i> <i>1,19758172+</i> <i>1564803</i> <i>5,05,76,386</i> | <i>50,642,471</i> <i>1197581172</i> <i>1199145975</i> | <i>50,642,471</i> <i>5,05,76,386</i> |
| <i>iii</i> | <i>Aggregate of Opening and Closing value of Investment (Average Value of Investment) >2% of above as per Rule 8D</i> | <i>1197581172</i> <i>X 0.5%</i> | <i>5987905</i> | <i>5987905</i> |
| | <i>Total disallowance [Aggregate of (i), (ii) &(iii)]</i> | | | <i>5,65,64,291</i> |

Therefore, an amount of Rs 5,65,64,291/- have to be disallowed u/s 14A read with Rule 8D of I.T.Rules, 1962 and added to the total income of the assessee. However, total expenses debited in P&L A/c by the assessee comes to Rs.5,06,73,874/= (5,07,80,866 – Rs.19,550 – Rs.87,442), therefore the additions in this account is restricted to Rs.5,06,73,874/= Devata tradelink 08-09.”

5. As is evident from the aforementioned extract of the assessment order, the AO had applied Rule 8D of the Rules without having regard to the fact that the exempt income that the respondent/assessee earned was only Rs.35,347/- and that against the said income, it had *suo motu* quantified the disallowance under Rule 8D of the Rules as Rs.87,442/-.



6. In a series of judgments it has been held that the disallowance under Section 14A of the Act read with Rule 8D of the Rules cannot exceed the exempt income. In this regard, it would be useful to extract the observations made in *Joint Investments Pvt Ltd v. Commissioner of Income Tax*, 2015:DHC:1804-DB:

*“9.The third, and in the opinion of this court, important anomaly which we cannot be unmindful is that whereas the entire tax exempt income is Rs. 48,90,000/-, the disallowance ultimately directed works out to nearly 110% of that sum, i.e., Rs.52,56,197/-. By no stretch of imagination can Section 14A or Rule 8D be interpreted so as to mean that the entire tax exempt income is to be disallowed. **The window for disallowance is indicated in Section 14A, and is only to the extent of disallowing expenditure “incurred by the assessee in relation to the tax exempt income”.** This proportion or portion of the tax exempt income surely cannot swallow the entire amount as has happened in this case.”*

[Emphasis is ours]

7. Therefore, to our minds, the addition made by the AO, which was sustained by the CIT(A), was wholly unsustainable and thus, according to us, the Tribunal correctly deleted the addition.

8. That said, Mr Ruchir Bhatia, learned senior standing counsel, who appears on behalf of the appellant/revenue, at the fag end of the proceedings came up with the argument that the CIT(A) had taken recourse to an alternate rationale based on the provisions of Section 36(1)(iii) of the Act. In this context, our attention was drawn to the following parts of the order passed by the CIT(A):

“5.4...The above facts show that appellant has made Long Term Investment of Rs.119,75,81,172/- by taking the loan of Rs.119,00,00,000/- on which it has paid interest of Rs.5,06,42,471/-. This Long Term investment is neither shown nor claimed as stock in trade by the appellant. The dividend income is bound to be earned on this huge investment of Rs.119,75,81,172/- in coming years' though the appellant might not have earned dividend income during the year under consideration. Therefore, the claim of the appellant that they were trader in the shares and have not made Long Term investment for earning of dividend income is not correct. I am of the considered view that no income, whether exempt or not, can be



earned without making some expenditure in addition to the interest expenditure...

xxx xxx xxx

5.7 In view of the facts and circumstances of the case and judicial pronouncements discussed above, I hold that the AO was fully justified in making the disallowance of Rs.5,06,73,874/- u/s 14A read with Rule 80. **Even otherwise, the claim of the appellant is not allowable u/s 36(iii) of the Act as the interest paid is in respect of capital borrowed which has been utilized for investment purposes and not for any business purpose.** Therefore, the impugned addition of Rs.5,06,73,874/- made by the AO is upheld and the above ground of appeal raised by the appellant is rejected.”

[Emphasis is ours]

9. In this regard, Mr Gautam Jain, who appears on behalf of the respondent/assessee, has drawn our attention to the following tables extracted from the written submissions filed on behalf of the respondent/assessee:

Table 1: The details of purchase and sale of shares and, profits, declared and, assessed to tax along with details of mutual fund is as under:

| Sr. No. | Name | Opening | Purchase (quantity) | Sale (quantity) | Closing (quantity) | Profit | Exempt income (if any) | Treatment by assessee | Treatment by AO |
|---------|---|---------|------------------------------|-----------------------------|-----------------------------|--------------------|------------------------|--|---------------------------------|
| i) | Reliance Industries Limited | --- | 179,84,83,026 (7,00,000) | 182,05,29,302 (7,00,000) | --- | 2,20,46,276 | Nil | Taxable under head 'Profit and Gains from Business or Profession (PGBP)' | Accepted as offered by Assessee |
| ii) | Reliance Energy Limited | --- | 217,71,09,358 (11,00,000) | 100,25,30,887 (5,00,000) | 119,75,81,172 (6,00,000) | 2,30,02,701 | Nil | Taxable under head PGBP | Accepted as offered by Assessee |
| iii) | Reliance Power limited | --- | 60,57,73,344 (14,45,792) | 61,77,76,068 (14,45,792) | --- | 1,20,02,724 | Nil | Taxable under head PGBP | Accepted as offered by Assessee |
| iv) | Reliance Power Limited | --- | 1,46,78,976 (40,000) | 1,75,86,330 (40,000) | --- | 29,07,354 | Nil | Taxable under head PGBP | Accepted as offered by Assessee |
| v) | Future & option (settled during the year) | --- | | | | 1,10,75,439 | Nil | Taxable under head PGBP | Accepted as offered by Assessee |
| vi) | Reliance Liquid fund | --- | 12,59,35,347 (82,62,065) | 12,59,35,347 (82,62,065) | --- | --- | 35,347 | Claimed as exempt by assessee | Accepted as offered by Assessee |
| | Total | | | | 119,75,81,172 | 7,10,34,493 | | | |

**Table II:**

As a result of the above the profit is as under:

| Sr. No. | Particulars | Amount (Rs.) | |
|---------|--|--------------------|--------------------------|
| | | As per Assessee | As per Assessing Officer |
| i) | Income (A) | | |
| | Profit on sale of shares (A1) | 7,10,34,493 | 7,10,34,493 |
| | Add back: STT on shares (A2) | 1,05,61,731 | 1,05,61,731 |
| | Total income declared on purchase and sale of shares (A) = (A1+A2) | 8,15,96,224 | 8,15,96,224 |
| ii) | Expenditure | | |
| | Interest on Loans | 5,06,42,471 | --- |
| | Stamp Paper Exps. | 800 | --- |
| | Filing fees | 1,200 | --- |
| | Printing & Stationery | 460 | --- |
| | Audit Fees | 1,12,360 | --- |
| | Misc. Exps. | 4,075 | --- |
| | Total Expenses (B) | 5,07,61,366 | --- |
| iii) | Add Back | | |
| | Disallowance u/s 14A (C) | 87,442 | --- |
| iv) | Expenses (D) = (B-C) | 5,06,73,924 | --- |
| v) | Add: Preliminary expenses claimed (E) | 3,900 | 3,900 |
| vi) | Net Expenditure (F) = (D+E) | 5,06,77,824 | 3900 |
| vii) | Gross Taxable Income (G) = (A-D-E) | 3,09,18,400 | 8,15,92,324 |

Table III:

| Sr. No | A.Y | Investment | | Exempt Income | Disallowance (if any) | Assessment u/s | Remarks (Status of disallowance) |
|--------|---------|---------------|---------------|---------------|-----------------------|----------------|----------------------------------|
| | | Opening | Closing | | | | |
| i) | 2008-09 | Nil | 1,197,581.172 | 35,347 | 50,673,874 | 143(3) | Disputed in Appeal |
| ii) | 2009-10 | 1,197,581.172 | Nil | 6,407,215 | Nil | 143(1) | N.A. |
| iii) | 2010-11 | Nil | Nil | 4,404 | Nil | 143(3) | N.A. |
| iv) | 2011-12 | Nil | Nil | Nil | Nil | 143(1). | N.A. |
| v) | 2012-13 | Nil | 300,000,000 | Nil | Nil | 143(3) | N.A. |
| vi) | 2013-14 | 300,000,000 | 300,000,000 | Nil | Nil | 143(1). | N.A. |
| vii) | 2014-15 | 300,000,000 | 21,010,000 | Nil | Nil | 143(1). | N.A. |

10. We may note that the facts and figures in the said tables are not disputed by Mr Bhatia. Notably, although the appellant/revenue was given an opportunity, it chose not to file the written submissions in the matter.

11. It would be evident upon perusal of the information given against Sr. No.(ii) in Table -I above that the respondent/assessee had purchased 11,00,000 shares of Reliance Energy Limited during FY 2007-08 [AY 2008-09] for an amount of Rs.217,71,09,358. Out of 11,00,000 shares, 5,00,000 shares were sold for Rs.100,25,30,887/-. Therefore, at the end of



the said FY, the respondent/assessee was left with 6,00,000 shares worth Rs.1,19,75,81,172/-.

12. The said 6,00,000 shares worth Rs.1,19,75,81,172/- were sold in the following FY i.e., FY 2008-09 [AY 2009-10] resulting in “NIL” closing balance. This aspect is evident from Table - III. Once again, the facts and figures given in the said table are not in dispute.

13. It is Mr Jain’s contention that although the AO was right in holding that in the balance sheet for FY in issue i.e., FY 2007-08, a part of the shares bought concerning Reliance Industries Ltd. (RIL) was shown as long term investment, they were sold and the profit earned therefrom was offered for imposition of tax. Mr Jain, thus, went on to state that the profit on the sale of all the shares mentioned in Table- II above, which included shares of RIL (except Reliance Liquid Fund) was Rs.7,10,34,493/-, which as indicated above, was offered for levy of tax. Therefore, the argument advanced by Mr Jain was that notwithstanding the depictions in the balance sheet, once the appellant/revenue has accepted the transaction as one concerning the sale of shares held as stock-in-trade, neither the CIT(A) nor the AO could have made an addition *qua* interest paid on loan availed by the respondent/assessee.

14. We tend to agree Mr Jain. The borrowings were for the purpose of business. The shares bought from borrowed funds were sold and this profit earned was offered for levy of tax, which was accepted by the appellant/revenue. It is perhaps for this reason that the question proposed by the appellant/revenue does not raise the issue concerning the application of borrowed funds for long-term investment, and hence unavailability of deductions *qua* interest accrued on it [See Section 36(1)(iii)]. The question,



as proposed, is confined to the disallowance of Rs.5,06,73,874/- made under Section 14A of the Act read with Rule 8D of the Rules. In any event, the well-established principle is that the manner of treatment of an item concerning expenditure and income in the books of accounts or financial statement does not determine its liability under the Act [See ***Kedarnath Jute Mfg. Co. Ltd. v. Commissioner of Income Tax, (Central), Calcutta*** (1972) 3 SCC 252]

15. In our view, at this juncture, the appellant/revenue cannot spring upon the respondent/assessee a new case which is not articulated in the appeal preferred before us.

16. Since, as noticed above, the exempt income was only Rs.35,347/-, the disallowance ordered by the AO amounting to Rs.5,06,73,874/- could not have been made in view of the position in law enunciated in the judgment referred to hereinabove.

17. Thus, according to us, the impugned order does not call for any interference as no substantial question of law arises for consideration by this court.

18. The appeal is, accordingly, closed.

RAJIV SHAKDHER, J

GIRISH KATHPALIA, J

NOVEMBER 22, 2023/pmc