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

Date of Decision:17.11.2020

\+ **ITA 136/2020**

PR. COMMISSIONER OF INCOME TAX LTU, NEW DELHI ....Appellant

Through: Mr. Ajit Sharma, Advocate with Mr. Luqman Hasan, Advocate.

versus

M/S MAHANAGAR TELEPHONE NIGAM LTD ..Respondent

Through: Mr. Ved Jain, Advocate with Ms. Umang Luthra, Advocate.

CORAM:
HON'BLE MR. JUSTICE MANMOHAN
HON'BLE MR. JUSTICE SANJEEV NARULA

JUDGMENT

SANJEEV NARULA, J. (Oral)

CM APPL. 7152/2020 (For Condonation of Delay in Re-filing)

1. For the reasons stated in the application, the delay of 74 days in re-filing the present appeal is condoned.

2. Accordingly, the application is allowed.

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3. The instant appeal under Section 260A of the Income Tax Act, 1961 ("the Act") is directed against the common order dated 12.06.2019 passed by the Income Tax Appellate Tribunal ("ITAT"), whereby the learned ITAT has

decided the issues, urged in the present appeal, in favour of the Respondent-Assessee. In Appeal No. 2368/Del/2016, preferred by the Respondent-Assessee, the learned ITAT has accepted Respondent-Assessee's contention with respect to the addition pertaining to the prior period income; and in Appeal No. 3299/Del/2016, filed by the Appellant-Revenue, the learned ITAT has restricted the disallowance, under Section 14A read with Rule 8D (2) (iii), in respect of expenditure incurred in relation to income not includible in the total income.

4. Briefly stated, the factual matrix leading to the filing of the present appeal is that the Respondent-Assessee, a public sector undertaking filed a return of income for AY 2011-12, declaring a total loss of Rs. 14,76,94,22,781/-. The Assessing Officer ("AO") vide order dated 18.03.2014 ("Assessment Order") framed the assessment under Section 143(3) of the Act and determined the total loss of Rs.14,48,28,78,030/-. Respondent-Assessee's appeal against the Assessment Order before the Commissioner of Income Tax (Appeals) ["CIT(A)"] was partly allowed vide order dated 01.03.2016. Thereafter, both the Respondent-Assessee as well as the Appellant-Revenue assailed the order of CIT (A) before the learned ITAT. The same were decided vide common impugned order, whereby the issues urged in the present appeal, have been decided in favour of the Respondent-Assessee.

5. Mr. Ajit Sharma, learned Senior Standing counsel appearing for the Appellant-Revenue, at the outset submits that the challenge in the present appeal is confined to the findings of the learned ITAT that are against the Appellant-Revenue qua (i) the disallowance under Section 14A r/w Rule 8D(2)(iii) in respect of expenditure incurred in relation to income not includible in the total income; and (ii) the addition with respect to the prior

period income and refers to the proposed substantial questions of law, extracted hereinbelow:-

> *"a) Whether on the facts and in the circumstances of the case and in law, the Ld. ITAT is justified in restricting the disallowance to only 0.5% of average investment income of Rs 1,33,74,000/- in terms of section 14A r. w. Rule 8D(2)(iii) as against Rs 9,69,57,875/- disallowed u/s· 14A r. w. Rule 8D(2)(ii) and (iii) ?*
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> *b) Whether on the facts and in the circumstances of the case and in law, the Ld. ITAT has erred in deleting the addition of Rs. 3,36,80,000/- made by the assessment officer on account of prior period income?*
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> *c) Whether the order passed by ITAT is bad in law and on facts?"*

6. Mr. Sharma argues that the learned ITAT was not justified in restricting the disallowance in terms of Section 14A/w Rule 8D(2)(iii) only to the extent of 0.5% of average investment income of Rs. 1,33,74,000/-as against Rs.9,69,57,875/ -. He submits that the Respondent-Assessee had made certain investments relating to tax-free income. He further submits, that as on 31.03.2011, the Respondent-Assessee had made an investment amounting to Rs.494,65,80,000/- and received dividend income amounting to Rs. 3,41,50,000/-. The said dividend income had been exempted under Section 10 of the Act and furthermore the Respondent-Assessee had also paid interest on its borrowings. Thus, in view of the massive turnover of the Respondent-Assessee and its complicated flow of funds it was difficult to identify as to which funds had been used for what purpose. Since it was difficult to segregate the business arrangement of the Respondent-Assessee between exempt income earning activity and other businesses, the learned ITAT has erred in restricting the disallowance. He also submits that the purpose behind Section 14A of the Act has been ignored. He emphasizes

that the reason behind the statute not permitting deduction of the expenditure, incurred in relation to income which does not form part of the total income, is to ensure that the assessee does not get double benefit. Once a particular income itself is not included in the total income and is exempted from tax, there is no reasonable basis for giving benefit of deductions of the expenditure incurred in earning such an income. As regards the addition of prior period income, he argues that the learned ITAT has erred in deleting the addition of Rs. 3,36,80,000/- made by the AO on account of prior period income. The direction of the learned ITAT to net off prior period income and expenditure, and to tax only the net income is erroneous as it results in allowance of Rs. 1.80 Crores to the Respondent-Assessee without verification by the AO as to whether such expenses had actually crystallized or not.

7. We have duly considered and reflected upon the submissions advanced by Mr. Sharma. The records reveal that the AO made disallowance under Section 14A read with Rule 8D amounting to Rs. 9,69,57,875/- and made addition accordingly. In appeal before the CIT (A) it was restricted to 0.5% of the average investment income of Rs. 1,33,74,000/- as against Rs. 9,69,57,875/-. The learned ITAT considered the challenge of the Appellant-Revenue on this ground and observed as under: -

> "7. *We have heard both the parties and perused all the relevant material available on record. The CIT(A) held as under*:
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> > *"6.1. From the schedule of investments, it is noticed that the total investments of Rs. 4946.58 million INR include an investment of Rs. 2500/-million INR in bonds besides an investment of Rs.1446. 58 million INR in subsidiaries and an investment of Rs. 1000/- million INR in the preference shares of ITI limited. The above figures are the figures of closing balance of the*

investments. The opening balances of these investments are same except the investments in subsidiary companies which were Rs. 1245.77 million INR. As regards LIC Mutual fund, the opening investment was Rs. 349.6 million INR which reduced to nil at the end of the year. The Total investments (closing balance) of Rs. 4946.58 million INR constitute 3.5% of the closing balance of share capital, reserves & surplus and loans totaling Rs. 1,41,021.56 million INR. In view of this factual position and also considering the fact that the assessee has interest free funds in the form of share capital and reserves & surplus of Rs. 66,464.81 million INR (being the closing balance), there is no reason why the appellant's claim that the interest bearing funds have not been used for making investment should not be accepted. Therefore, the disallowance of interest under rule 14 A r. w. rule 8D (2)(ii) of Rs. 71.853 million INR is deleted. However, as regards the disallowance under rule 8D(2)(iii), being 0.5% of the average investments (income from which is exempt), the undersigned does not agree with the order of my predecessor that no administrative expenses were incurred in connection with such investments. In a large organisation like appellant, the investments needs to be regularly monitored and man hours of staff are used apart from other administrative expenses. Therefore, the appellant's claim that no such expenditure was incurred is not correct. Once it is held that the claim of the appellant is not correct, the only way to estimate the same, is under rule 8D (2)(iii) being 0. 5% of the average investments income from which, is exempt. The AO has worked out, this disallowance at Rs. 2,51,04,875/-. The value of average investments has been taken as the average of total investments mentioned in schedule F of the balance sheet. However, as discussed all the investments made, mentioned in schedule F do not yield exempt income. Therefore, the disallowance u/ s 14A r. w. rule 8D(2)(iii) is restricted to only 0.5% of average investment income from which, is exempt irrespective of where the said exempt income has been received during the A. Y. 11-12 or not. Consequently, ground no. 2 of the appeal is partly allowed."

The CIT(A) has rightly held that from the investment records it can be seen that all the investments mentioned in Schedule F do not yield exempt income. Thus, the CIT(A) properly held that disallowance u/s 14A r.w. Rule 8D(2)(iii) is restricted to only 5% of average investment income from which, is exempt irrespective of where the said exempt income was received during A.Y. 2011-12 or not. There is no need to interfere with the finding of CIT(A). Ground No.4 of the Revenue's appeal is dismissed."

8. It becomes clear by reading the aforesaid extracted portion that the CIT(A) deleted the disallowance of interest under Section 14 A r/w Rule 8D (2)(ii), considering the factual position and the fact that the Respondent-Assessee had interest-free funds in the form of share capital and reserves & surplus. As regards the disallowance under Rule 8D(2)(iii), it was observed that Respondent-Assessee's claim that no expenditure was incurred is not correct. In these circumstances, expenditure was to be estimated under Rule 8D(2)(iii) being 0.5% of the average investment income which is exempt. It was noticed that value of average investment had been calculated as the average of total investments, mentioned in Schedule F. However, the CIT (A) noted that since all the investments mentioned in Schedule F do not yield exempt income, disallowance under Section 14A read with Rule 8D(2)(iii) has been restricted only to 0.5% of the average investment income which is exempt, irrespective of whether such exempt income was received during AY 2011-12. This approach has been upheld by the learned ITAT. We do not find any perversity in the same or find any reason to entertain the present appeal to interfere with this finding that is based on facts.

9. As regards the second ground urged by Mr Sharma, relating to the deletion of addition of Rs. 3,36,80,000/-, we find that the learned ITAT has observed that during the year under consideration, the Respondent-Assessee

has shown prior period income of Rs. 3,36,80,000/- and has further shown prior period expenses amounting to Rs.1,80,10,000/-. It has also been noticed that the profit and loss account of the Respondent-Assessee shows that it has neither taken the prior period income in its taxable profit, nor has considered the prior period expenses i.e. the prior period adjustments have been made by the Respondent-Assessee on below the line profit. Thus, having regard to the aforesaid fact, the learned ITAT has observed as under:

> *"17. We have heard both the parties and perused the material available on record. During the year under consideration, assessee has shown – prior period income of Rs. 3,36,80,000/- and has further shown prior period expenses amounting to Rs. 1,81,10,000/-. A perusal of the Profit and Loss account of the assessee company shows that the company has neither taken the prior-period income in its taxable profit, now has considered the prior period expenses, i.e. the prior period adjustments have been made by the assessee company on below the line profit. The disallowance of prior period expense has to be computed by netting off the prior period income against the prior period expenditure. Thus, the case laws referred by the Ld. AR are apt in the present case. The Assessing Officer as well as the CIT(A) ignored these factual and legal aspects and were not correct in making the entire addition without netting off. We, therefore, remand back this issue with the direction to the Assessing Officer to net off prior period income and prior period expenditure and only tax the net income accordingly. Needless to say, the assessee be given opportunity of hearing by following principles of natural justice. Therefore, Ground No.4 of the Assessee's appeal is partly allowed for statistical purpose."*

10. On this issue, since factual aspects have to be verified, the learned ITAT has remanded back this issue with a direction to the AO to net off prior period income and the prior period expenditure and tax only the net income. This direction calls for no interference by this Court.

11. For the foregoing reasons, we find no ground to entertain the present appeal. No question of law much less substantial question of law has been urged in the present appeal which requires our consideration. Accordingly, the present appeal is dismissed.

SANJEEV NARULA, J

MANMOHAN, J

NOVEMBER 17, 2020
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