IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

INCOME TAX APPEAL No.244 of 2016 (O&M)
DATE OF DECISION: 30.01.2017

The Pr. Commissioner of Income Tax, Patiala

.....Appellant

versus

State Bank of Patiala

.....Respondent

CORAM:- HON'BLE MR.JUSTICE S.J.VAZIFDAR, CHIEF JUSTICE
HON'BLE MR. JUSTICE DEEPAK SIBAL

Present: Mr. Zora Singh Klar, Advocate for the appellant

Mr. Sanjay Bansal, Senior Advocate with
Mr. B.M. Monga, Advocate,
Mr. Amit Parsad, Advocate and
Mr. Rohit Kaura, Advocate for the respondent

..

S.J. VAZIFDAR, CHIEF JUSTICE:

This is an appeal against the order of the Income Tax Appellate Tribunal allowing the respondent/assessee's appeal against the order of the Commissioner of Income Tax (Appeals). The appeal pertains to the Assessment Year 2008-09.

2. The appeal is admitted on the following substantial question of law:-

> "Whether in the facts and circumstances of the case, the Hon'ble ITAT is right in law in deleting the addition made on account of disallowance under section 14A of the Income Tax Act, 1961?"

The question really is whether the provisions of section 14A of the Income Tax Act (for short – 'the Act') apply where the

exempt income such as dividend or interest is earned from securities held by the assessee as its stock-in-trade. The assessee had raised other issues as well. The Tribunal having decided the above question in favour of the assessee did not decide the other issues.

3. As we have also decided the question in favour of the assessee, it follows that section 14A is inapplicable altogether. The appeal must, therefore, be dismissed. Had we decided the issue against the assessee, we would have remanded the matter to the Tribunal for its decision on the other aspects, such as, whether the investments and securities yielding exempt income were from interest free funds/assessee's own funds or from interest bearing funds as the Tribunal had not decided the same.

4. The respondent filed a return declaring an income of about Rs.670 crores which was selected for scrutiny. The return showed dividend income exempt under section 10(34) and (35) of about Rs.11.07 crores and net interest income exempt under section 10(15)(iv)(h) of about Rs.1.12 crores. The total exempt income claimed in the return was, therefore, Rs.12,19,78,015/-.

The assessee while claiming the exemption contended that the investment in shares, bonds, etc. constituted its stock-in-trade; that the investment had not been made only for earning tax free income; that the tax free income was only incidental to the assessee's main business of sale and purchase of securities and, therefore, no expenditure had been incurred for earning such exempt income; the expenditure would have remained the same even if no dividend or interest income had been earned by the assessee from the said securities and that no expenditure on proportionate basis could be allocated against exempt income. The assessee also

contended that in any event it had acquired the securities from its own funds and, therefore, section 14A was not applicable.

5. The Assessing Officer restricted the disallowance to the amount which was claimed as exempt income and added the same to the assessee's income by applying section 14A. The Assessing Officer accordingly applied rule 8D for determining the expenditure to be disallowed as per section 14A. He computed the exempt income as claimed by the assessee, namely, about Rs.12.20 crores. The Assessing Officer found the total expenses allocated against exempt income to be Rs.40.72 crores, but held that the same should not exceed the exempted income and, therefore, he restricted the expenses to the extent of exempt income claimed by the assessee i.e. about Rs.12.20 crores and added the same to the assessee's income.

6. The CIT (Appeals) by the said notice for enhancement under section 251 enquired of the assessee its obligation to maintain the securities. The assessee replied that the investment in shares and bonds was not made under any obligation under the Banking Regulation Act, 1949, but that it was dealing in shares and bonds as a trader which was permitted by section 6 of the Banking Regulation Act, 1949. The CIT (Appeals) held as follows: In view of section 14A the assessee was not to be allowed any deduction in respect of income which is not chargeable to tax. The assessee had incurred interest expenditure and administrative expenditure for earning its income both exempt and non exempt. The Assessing Officer had wrongly restricted the disallowance to the extent of exempt income claimed by the assessee to Rs.12.20 crores and that the entire sum of Rs.40.72 crores should have been disallowed by

the Assessing Officer as there was no legal provision either in section 14A or rule 8D to limit the disallowance to the amount of dividend received. Expenditure incurred in respect of earning taxable income alone can be allowed as deduction and expenses incurred in relation to exempt income were not to be allowed as a deduction. The application of rule 8D by the Assessing Officer was also upheld.

7. The Tribunal set aside the order of the Assessing Officer and of the CIT (Appeals). The contention on behalf of the assessee was that as it held the securities as stock-in-trade the income earned therefrom was only incidental to its business and that, therefore, the provisions of section 14A were not attracted. The Tribunal referred to a CBDT Circular No.18/2015 dated 02.11.2015 which states that income arising from investment of a banking concern is attributable to the business of banking which falls under the head “Profits and gains of business and profession”. The circular states that shares and stock held by the bank are stock-in-trade and not investment. Referring to certain judgments, which we will also refer to, and the earlier orders of the Tribunal, it was held that if shares are held as stock-in-trade and not as investment even the disallowance under rule 8D would be nil as rule 8D(2)(i) would be confined to direct expenses for earning the tax exempt income.

8. In view of the issue involved, it is necessary to refer to the facts only briefly.

9. The CIT (Appeals) by the said notice for enhancement under section 251 enquired of the assessee its obligation to maintain the securities. The assessee rightly replied that the

investment in shares and bonds was not made under any obligation under the Banking Regulation Act, 1949, but that it was dealing in shares and bonds as a trader which was permitted by section 6 of the Banking Regulation Act, 1949. The assessee was, in view of section 6 of the Banking Regulation Act, 1949, entitled to purchase and sell such securities. Section 6 specifies the forms of business in which banking companies may engage. Sub-section (1) permits a banking company in addition to the business of banking to deal, inter alia, in scrips and other instruments and securities whether transferable or negotiable or not as well as in stock, funds, shares, debentures, debenture stocks, bonds, securities and investments of all kinds. Accordingly, any profit or loss arising from such activities is liable to be shown either as a business income or business loss for the purposes of computation of income under the Act.

10. Mr. Bansal rightly contended that the assessee is engaged in the purchase and sale of shares as a trader with the object of earning profit and not with a view to earn interest or dividend. The assessee does not have an investment portfolio. The securities constitute the assessee's stock-in-trade. The Department, in fact, rightly accepted, as a matter of fact, that the dividend and interest earned was from the securities that constituted the assessee's stock-in-trade. The same is, in any event, established. The assessee carried on the business of sale and purchase of securities.

11. The submission is firstly supported by the said Circular No.18, dated 02.11.2015, issued by the CBDT, which reads as under:-

> "Subject: Interest from Non-SLR securities of Banks – Reg.

> It has been brought to the notice of the Board that in the case of Banks, field officers are taking a view that, "expenses relatable to investment in non-SLR securities need to be disallowed u/s 57(i) of the Act as interest on non-SLR securities is income from other sources."
>
> 2. Clause (id) of sub-section (1) of Section 56 of the Act provides that income by way of interest on securities shall be chargeable to income-tax under the head "Income from Other Sources", if, the income is not chargeable to income-tax under the head "Profits and Gains of Business and Profession".
>
> 3. The matter has been examined in light of the judicial decisions on this issue. In the case of CIT Vs Nawanshahar Central Cooperative Bank Ltd. [2007] 160TAXMAN 48(SC), the Apex Court held that the investments made by a banking concern are part of the business of banking. Therefore, the income arising from such investments is attributable to the business of banking falling under the head "Profits and Gains of Business and Profession".
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> 3.2 Even though the abovementioned decision was in the context of co-operative societies/Banks claiming deduction under section 80P(2)(a)(i) of the Act, the principle is equally applicable to all banks/commercial banks, to which Banking Regulation Act, 1949 applies.
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> 4. In the light of the Supreme Court's decision in the matter, the issue is well settled. Accordingly, the Board has decided that no appeals may henceforth be filed on this ground by the officers of the Department and appeals already filed, if any, on this ground before Courts/Tribunals may be withdrawn/not pressed upon. This may be brought to the notice of all concerned." (emphasis supplied)

12. The Circular carves out a distinction between stock-in-trade and investment and provides that if the motive behind purchase and sale of shares is to earn profit then the same would be treated as trading profit and if the object is to derive income by way of dividend then the profit would be said to have accrued from the investment. If the assessee is found to have treated the shares and securities as stock-in-trade, the income arising therefrom would be business income. A loss would be a business

loss. Thus, as submitted by Mr. Bansal, an assessee may have two portfolios, namely, investment portfolio and a trading portfolio. In the case of the former, the securities are to be treated as capital assets and in the latter as trading assets. We will demonstrate later that section 14A would be applicable only to income arising from the investment portfolio and not from stock-in-trade i.e. the trading portfolio. The assessee did not have an investment portfolio.

13. Mr. Bansal then relied upon the judgment of the Supreme Court in Commissioner of Income-tax v. Nawanshahar Central Co-operative Bank Ltd., [2007] 289 ITR 6 (SC), which reads as under:-

> "1. Delay condoned. Leave granted.
> 2. This Court has consistently held that investments made by a banking concern are part of the business of banking. The income arising from such investments would, therefore, be attributable to the business of bank falling under the head "Profits and gains of business" and thus deductible under Section 80-P(2)(a)(i) of the Income Tax Act, 1961. This has been so held in Bihar State Coop. Bank Ltd. v. CIT [AIR 1960 SC 789 : (1960) 3 SCR 58 : (1960) 39 ITR 114:], CIT v. Karnataka State Coop. Apex Bank [(2001) 7 SCC 654 : 2001 Supp (2) SCR 35] and CIT v. Ramanathapuram Distt. Coop. Central Bank Ltd. [(2009) 17 SCC 620: (2002) 255 ITR 423]
> 3. The principle in these cases would also cover a situation where a cooperative bank carrying on the business of banking is statutorily required to place a part of its funds in approved securities. The appeals are accordingly dismissed without costs."

14. The investments made by the assessee in the case before us are part of its banking business and the income arising from trading in the securities is attributable to the business of the bank/assessee falling under the head "Profits and gains of business". Further the securities dealt with in the course of such trading constitutes the assessee's stock-in-trade.

15. Mr. Bansal then contended that as the shares, bonds, debentures, etc. purchased by the assessee constituted its stock-in-trade, the provisions of section 14A were not applicable. The submission is well founded.

16. Section 14A, in so far as it is relevant, reads as under:-

> "14-A.Expenditure incurred in relation to income not includible in total income.—For the purposes of computing the total income under this 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 this Act:
>
> Provided that nothing contained in this section shall empower the 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 assessee under Section 154, for any assessment year beginning on or before the 1st day of April, 2001."

17. Under section 14A, an expenditure can be disallowed only if it is incurred by the assessee in relation to income exempt from tax. The dividend or interest from the assessee's stock-in-trade i.e. the securities was exempt from tax in view of sections 10(15)(iv)(h),(34) and (35). This was incidental to its business of banking. The business income on account of the assessee trading in the securities is assessable under the head "Profits and gains of business and profession". The expenditure incurred in relation to stock-in-trade arising as a result of investment in shares and debentures is deductible under sections 28 to 37.

There is a distinction between stock-in-trade and investment. The object of earning profit from trading in securities is different from the object of earning income, such as, dividend and interest arising therefrom. The object of trading in securities

does not constitute the activity of investment where the object is to earn dividend or interest.

18. Mr. Klar, the learned counsel appearing on behalf of the appellant, agreed that the said securities were held by the respondent as stock-in-trade. He, however, submitted that the plain language of section 14A makes it applicable to any income which does not form part of the total income. According to him, therefore, it is immaterial which head of income of section 14 the income falls under, namely, salaries, income from house properties, profits and gains of business or profession, capital gains or income from any other sources. Under section 14A, no deduction is to be allowed in respect of the expenditure incurred by the assessee in relation to "income" which does not form part of the total income under the Act. He emphasised the term "income" and submitted that the nature of the "income" is not specified.

19. The assessee showed its dividend income exempt under sections 10(34) and 10(35). It is true that dividend and interest also constitute income.

Sections 10(34) and 10(35) read as under:-

"10.Incomes not included in total income.—In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—

…… ….. ….. …… …… …… …….

(34) any income by way of dividends referred to in section 115-O;

…… ….. ….. …… …… …… …….

(35) any income by way of—

(a) Income received in respect of the units of a Mutual Fund specified under clause (23D); or

(b) income received in respect of units from the Administrator of the specified undertaking; or

(c) income received in respect of units from the specified company:

…… ….. ….. …… …… …….”

Section 10 provides, inter alia, that income by way of dividend, referred to in section 115-O, is not to be included in computing the total income. Thus, the language of section 10 itself indicates that dividend referred to therein, is income and for that reason section 10 provides that such income shall not be included in computing the total income of the previous year.

20. Thus, dividend and interest arising out of the securities is income and if expenditure is incurred in relation to such income, no deduction can be allowed in respect thereof. The question, however, is whether any expenditure was incurred by the assessee to earn this exempt income.

21. Before going further, it would be useful to refer to the judgment of the Supreme Court relied upon by Mr. Klar and Mr. Bansal. Both the learned counsel submitted that the point stands concluded in their favour by the judgment of the Supreme Court in Commissioner of Income-Tax vs. Walfort Share and Stock Brokers P. Ltd., [2010] 326 ITR 1 (SC). The judgment we find supports the assessee, although it dealt with an entirely different type of case.

In that case, the assessee earned income mainly from share trading and brokerage. It purchased the mutual funds on 24.03.2000 which was shortly before the record date and earned dividend of about Rs.1.82 crores. The NAV stood reduced from Rs.17.23 to Rs.13.23 per unit three days later on 27.03.2000 on account of the dividend payment. The assessee then sold the units

for an amount of about Rs.5.90 crores and received incentive of about Rs.23.77 lacs. The assessee claimed the dividend received by it of about Rs.1.82 crores to be exempt from tax under section 10(33) and also claimed a set off of about Rs.2.09 crores as loss incurred on the sale of the units.

The question was whether “return of investment” or “cost recovery” would fall within the expression “expenditure incurred” in section 14A. The main issue, as stated in the judgment, was whether in a dividend stripping transaction (alleged to be a colourable device by the Department), the loss on sale of units could be considered as expenditure in relation to earning of dividend income exempt under section 10(33), disallowable under section 14A of the Act.

On behalf of the Revenue, it was claimed, in the alternative, that since the price of units necessarily included the price of dividend as an identifiable element embedded therein to which a definite value could be assigned at the time of purchase, the so called dividend is, in effect, paid for. In such circumstances, that part of the price of units which represented the cost of dividend is the expenditure incurred for obtaining exempt income and if that is the case then section 14A requires that such expenditure should be netted against the receipt of dividend.

Although the facts of the case were different from those before us, the Supreme Court dealt with the scope of section 14A. The Supreme Court held as follows:-

> “The main issue involved in this batch of cases is—whether in dividend stripping transaction (alleged to be a colourable device by the Department) the loss on sale of units could be considered as expenditure in relation to earning of dividend

income exempt under Section 10(33), disallowable under Section 14-A of the Act? According to the Department, the differential amount between the purchase and sale price of the units constituted "expenditure incurred" by the assessee for earning tax-free income, hence, liable to be disallowed under Section 14-A. As a result of the dividend payout, according to the Department, the NAV of the mutual fund, which was Rs. 17.23 per unit on the record date, fell to Rs. 13.23 on 27-3-2000 (the next trading date) and, thus, Rs. 4 per unit, according to the Department, constituted "expenditure incurred" in terms of Section 14-A of the Act. In its return, the assessee, thus, claimed the dividend received as exempt under Section 10(33) and also claimed set-off for the loss against its taxable income, thereby seeking to reduce its tax liability and gain tax advantage.

The insertion of Section 14-A with retrospective effect is a serious attempt on the part of Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act against the taxable income (see Circular No. 14 of 2001 dated 22-11-2001). In other words, Section 14-A clarifies that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. In many cases the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of Section 14-A, the expenditure incurred in respect of exempt income was being claimed against the taxable income. The mandate of Section 14-A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The basic reason for insertion of Section 14-A is that certain incomes are not includible while computing total income as these are exempt under certain provisions of the Act. In the past, there have been cases in which deduction has been sought in respect of such incomes which in effect would mean that tax incentives to certain incomes were being used to reduce the tax payable on the non-exempt income by debiting the expenses, incurred to earn the exempt income, against taxable income. The basic principle of taxation is to tax the net income i.e. gross income minus the expenditure. On the same analogy the exemption is

> also in respect of net income. Expenses allowed can only be in respect of earning of taxable income. This is the purport of Section 14-A. In Section 14-A, the first phrase is "[f]or the purposes of computing the total income under this Chapter" which makes it clear that various heads of income as prescribed under Chapter IV would fall within Section 14-A. The next phrase is, "in relation to income which does not form part of the total income under this Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of Section 14-A. Further, Section 14 specifies five heads of income which are chargeable to tax. In order to be chargeable, an income has to be brought under one of the five heads. Sections 15 to 59 lay down the rules for computing income for the purpose of chargeability to tax under those heads. Sections 15 to 59 quantify the total income chargeable to tax. The permissible deductions enumerated in Sections 15 to 59 are now to be allowed only with reference to income which is brought under one of the above heads and is chargeable to tax. If an income like dividend income is not a part of the total income, the expenditure/deduction though of the nature specified in Sections 15 to 59 but related to the income not forming part of total income could not be allowed against other income includible in the total income for the purpose of chargeability to tax. The theory of apportionment of expenditures between taxable and non-taxable (sic income) has, in principle, been now widened under Section 14-A. Reading Section 14 in juxtaposition with Sections 15 to 59, it is clear that the words "expenditure incurred" in Section 14-A refer to expenditure on rent, taxes, salaries, interest, etc. in respect of which allowances are provided for (see Sections 30 to 37). Every payout is not entitled to allowances for deduction. These allowances are admissible to qualified deductions. These deductions are for debits in the real sense.
>
> (emphasis supplied)

22. As noted by the Supreme Court, the intention of the Parliament, therefore, was not to allow deduction in respect of any expenditure by the assessee in relation to income which does not form part of the total income under the Act. Section 14A clarifies that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. As also held by the

Supreme Court, the mandate of section 14A clearly is to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and, at the same time, avail the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The Supreme Court held that if an income like dividend income is not a part of the total income, the expenditure/deduction, though of the nature specified in sections 15 to 59 but related to the income not forming part of total income, could not be allowed against other income includable in the total income for the purpose of chargeability to tax. The income by way of dividend and interest received on the securities held by the respondent/assessee before us is, admittedly, not taxable income and an exemption in respect thereof was, in fact, claimed by the assessee under section 10(34) and (35). Had any expenditure been incurred in earning such income, it would have to be disallowed in view of section 14A.

23. There is no quarrel with these aspects. The question before us, however, is whether the assessee incurred any expenditure to earn the dividend or interest arising from such securities.

24. The Supreme Court thereafter dealt with the facts of the case before it which, as we mentioned earlier, related to dividend stripping. After the above observations, the Supreme Court proceeded to hold as under:-

> "A payback does not constitute an "expenditure incurred" in terms of Section 14-A. Even applying the principles of accountancy, a payback in the strict sense does not constitute an "expenditure" as it does not impact the profit and loss account.

> Payback or return of investment will impact the balance sheet whereas return on investment will impact the profit and loss account. Cost of acquisition of an asset impacts the balance sheet. Return of investment brings down the cost. It will not increase the expenditure. Hence, expenditure, return on investment, return of investment and cost of acquisition are distinct concepts. Therefore, one needs to read the words "expenditure incurred" in Section 14-A in the context of the scheme of the Act and, if so read, it is clear that it disallows certain expenditures incurred to earn exempt income from being deducted from other income which is includible in the "total income" for the purpose of chargeability to tax. As stated above, the scheme of Sections 30 to 37 is that profits and gains must be computed subject to certain allowances for deductions/expenditure. The charge is not on gross receipts, it is on profits and gains. Profits have to be computed after deducting losses and expenses incurred for business. A deduction for expenditure or loss which is not within the prohibition must be allowed if it is on the facts of the case a proper debit item to be charged against the incomings of the business in ascertaining the true profits. A return of investment or a payback is not such a debit item as explained above, hence, it is not "expenditure incurred" in terms of Section 14-A. Expenditure is a payout. It relates to disbursement. A payback is not an expenditure in the scheme of Section 14-A. For attracting Section 14-A, there has to be a proximate cause for disallowance, which is its relationship with the tax exempt income. Payback or return of investment is not such proximate cause, hence, Section 14-A is not applicable in the present case. Thus, in the absence of such proximate cause for disallowance, Section 14-A cannot be invoked. In our view, return of investment cannot be construed to mean "expenditure" and if it is construed to mean "expenditure" in the sense of physical spending still the expenditure was not such as could be claimed as an "allowance" against the profits of the relevant accounting year under Sections 30 to 37 of the Act and, therefore, Section 14-A cannot be invoked. Hence, the two asset theory is not applicable in this case as there is no expenditure incurred in terms of Section 14-A."
>
> (emphasis supplied)

25. Thus, what the Supreme Court held was that a payback in the scheme of section 14A is not an expenditure incurred in terms

of section 14A. Expenditure is a payout. It is in the facts of that case, therefore, that the Supreme Court held that the amount received cannot constitute expenditure. As the Supreme Court itself noted, the question was whether "return of investment" (emphasis supplied) or "cost recovery" would fall within the expression "expenditure incurred". That question does not arise before us and the result in that case is not relevant to the issue before us. What is relevant to this appeal are the observations regarding the ambit of section 14A which we have dealt with earlier.

26. What is of vital importance in the above judgment are the observations emphasised by us. Each of them expressly states that what is disallowed is expenditure incurred to "earn" exempt income. The words "in relation to" in section 14A must be construed accordingly. Thus, the words "in relation to" apply to earning exempt income. The importance of the observation is this.

We have held that the securities in question constituted the assessee's stock-in-trade and the income that arises on account of the purchase and sale of the securities is its business income and is brought to tax as such. That income is not exempt from tax and, therefore, the expenditure incurred in relation thereto does not fall within the ambit of section 14A.

Now, the dividend and interest are income. The question then is whether the assessee can be said to have incurred any expenditure at all or any part of the said expenditure in respect of the exempt income viz. dividend and interest that arose out of the securities that constituted the assessee's stock-in-trade. The answer must be in the negative. The purpose of the purchase of the said securities was not to earn income arising therefrom, namely,

dividend and interest, but to earn profits from trading in i.e. purchasing and selling the same. It is axiomatic, therefore, that the entire expenditure including administrative costs was incurred for the purchase and sale of the stock-in-trade and, therefore, towards earning the business income from the trading activity of purchasing and selling the securities. Irrespective of whether the securities yielded any income arising therefrom, such as, dividend or interest, no expenditure was incurred in relation to the same.

27. The securities were the assessee's stock-in-trade. Mr. Bansal, as noted earlier, submitted that the assessee did not hold the securities to earn dividend or interest, but traded in them and the dividend or interest accruing thereon was only a by-product thereof or an incidental benefit arising therefrom and would not, therefore, be subject to the provisions of section 14A. Mr.Bansal's reliance on a judgment of the Karnataka High Court in CCI Ltd. vs. Joint Commissioner of Income-tax, Udupi Range, [2012] 250 CTR 291 (Karnataka) is well founded. Paragraph-5 thereof reads as follows:-

> "5. When no expenditure is incurred by the assessee in earning the dividend income, no notional expenditure could be deducted from the said income. It is not the case of the assessee retaining any shares so as to have the benefit of dividend. 63% of the shares, which were purchased, are sold and the income derived therefrom is offered to tax as business income. The remaining 37% of the shares are retained. It has remained unsold with the assessee. It is those unsold shares have yielded dividend, for which, the assessee has not incurred any expenditure at all. Though the dividend income is exempted from payment of tax, if any expenditure is incurred in earning the said income, the said expenditure also cannot be deducted. But in this case, when the assessee has not retained shares with the intention of earning dividend income and the dividend income is incidental to his business of sale of shares, which remained unsold by the assessee, it cannot be said that the expenditure incurred in acquiring the shares has to be apportioned to the extent of dividend income and that should be disallowed from deductions. In that view of the

> matter, the approach of the authorities is not in conformity with the statutory provisions contained under the Act. Therefore, the impugned orders are not sustainable and require to be set aside. Accordingly, we pass the following: ….. ….. …" (emphasis supplied)

We are, in respectful agreement with the judgment and, in particular, the observations emphasised by us. The Division Bench held that when the assessee has not retained shares with the intention of earning dividend income and that the dividend income is incidental to the business of sale of shares it cannot be said that the expenditure incurred in acquiring the shares has to be apportioned to the extent of dividend income and that should be disallowed from deduction.

28. A financial decision of an assessee that trades in securities may and, in fact, would factor in the dividend or interest that the securities it acquires as its stock-in-trade yields or is likely to yield. Such a decision would be taken for acquisition, retention and disposal of the securities. That, however, is a financial consideration not with a view to earning the dividend or interest but with a view to assessing the price at which the security ought to be acquired, retained and sold. In other words, such dividend or interest is an aspect that the assessee takes into consideration for incurring the expenditure for the purpose of acquiring the stock-in-trade and dealing with it thereafter as well as for the sale thereof. This is entirely different from saying that the expenditure is incurred for earning the dividend or interest.

29. Once it is found that no expenditure was incurred in earning this income, there would be no further expenditure in relation thereto that falls within the ambit of section 14A. All

that the assessee does thereafter i.e. after dividend and interest is received is to protect, preserve and utilize the same. The expenditure incurred in that regard would be to administer and manage the same. In other words, such expenditure cannot be said to be for the purpose of earning the same. An amount once received as income loses its character as income and thereafter forms a part of the assets or wealth of the assessee. There is no concept, such as, once an income always an income.

30. It is not necessary to refer to Mr. Bansal's further submissions in support of this issue. We will, therefore, only note them. Mr. Bansal submitted that the computational provision of rule 8D is applicable to investments and not stock-in-trade. Rule 8D, therefore, would not come into play in relation to exempt income by way of dividend and interest from stock-in-trade and, accordingly, section 14A would not be applicable in relation to incidental income by way of tax free income, namely, interest or dividend which is exempt under sections 10(15)(iv)(h),(34) and (35). The term "investment" does not include stock-in-trade. He relied upon Accounting Standard (AS) 13, issued by the Institute of Chartered Accountants of India, to contend that there is a distinction between investment and stock-in-trade. Stock-in-trade is not investment as per clause 3.1 of AS 13. Rule 8D refers only to investment and not stock-in-trade. Section 14A and rule 8D constitute an integrated code and as the computation provisions do not apply, as the word used therein is investment and not stock-in-trade, the charging section cannot be read to include stock-in-trade. Mr. Bansal then relied upon the fact that variable-B in rule 8D(2)(ii) refers to "the average value of investment". He emphasised the word "investment". He relied upon clause 3.1 of AS 13 issued by the Institute of Chartered Accountants of India,

recognized under section 145(2) of the Act, in so far as it draws a distinction between investment and stock-in-trade. As per clause 3.1, stock-in-trade is not an investment. He contended that section 14A, which is a charging section, and rule 8D, which is the computation provision, constitute an integrated code and as the computation provisions do not apply, as the word used therein is "investment" and not "stock-in-trade", the charging section also cannot apply.

In view of what we have held, it is not necessary to consider this aspect of the matter.

31. The Tribunal having accepted the assessee's contention that income from the said securities is not covered by section 14A, did not consider the other contentions raised on behalf of the assessee. As we have decided this issue in favour of the assessee, it is not necessary to decide the other contentions raised by the assessee. These issues may well involve questions of fact some of which we indicated earlier. We, therefore, refrain from deciding them ourselves. Had we answered the question in favour of the Revenue, we would have directed the Tribunal to decide the other contentions raised by the assessee for the Tribunal had not decided the same.

32. The question of law is, therefore, answered in the affirmative in favour of the assessee. The appeal is accordingly dismissed.

(S.J. VAZIFDAR)
CHIEF JUSTICE

30.01.2017
parkash*

(DEEPAK SIBAL)
JUDGE

Note: Speaking/Non-speaking: Speaking
Whether reportable : Yes

For Subsequent orders see ITA-270-2016 Decided by HON'BLE MR. JUSTICE AJAY KUMAR MITTAL; HON'BLE MR. JUSTICE RAMENDRA JAIN

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