

IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD BENCH

**Before: Shri Mahavir Prasad, Judicial Member
And Shri Amarjit Singh, Accountant Member**

**ITA No. 2289/Ahd/2017
Assessment Year 2014-15**

The ITO, Ward-1(1)(1), Ahmedabad (Appellant)	Vs	M/s. Adroit Tradelink Pvt. Ltd, 145-1, Sector-14, Samrajya Apartment, Gandhinagar PAN: AAACJ3868J (Respondent)
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**Revenue by: Shri L.P. Jain, Sr. D.R.
Assessee by: Shri S.N. Divetia &
Shri Mehul Talera, A.Rs.**

Date of hearing : 12-07-2019
Date of pronouncement : 01-10-2019

आदेश/ORDER

PER : AMARJIT SINGH, ACCOUNTANT MEMBER:-

This revenue's appeal for A.Y. 2014-15, arises from order of the CIT(A)-1, Ahmedabad dated 30-08-2017, in proceedings under section 143(3) of the Income Tax Act, 1961; in short the Act.

2. The solitary ground of appeal of the revenue is against the decision of ld. CIT(A) in deleting the disallowance of Rs. 2,93,06,231/- made u/s. 14A r.w. Rule 8D of the IT Act, 1962.

3. The assessee has filed return of income on 26th Sep, 2014. The case was selected for scrutiny by issuing of notice u/s. 143(2) of the act on 1st Sep, 2015. During the course of assessment, the assessing officer noticed that assessee had made investment in shares, therefore, the assessee was asked to furnish the computation of disallowance u/s. 14A r.w. Rule 8D of the I.T. 1962. The assessee explained that assessee company was engaged in the business of trading in shares and securities and main motive of the company was not to earn exempt income and the income earned is incidental income to the main income. The assessing officer has not accepted the explanation of the assessee and computed the disallowance u/s. 14A r.w. Rule 8D to the amount of Rs. 2,93,06,231/- and added to the total income of the assessee.

4. The assessee has preferred appeal before the Id. CIT(A). The Id. CIT(A) deleted the addition stating that the assessee received the dividend on shares that were held as stock in trade and not as investment.

5. We have heard the rival contentions and perused the material on record. The assessing officer has made disallowance u/s. 14A of Rs. 2,93,06,231/-. The assessing officer has made aforesaid disallowance after applying section 14A r.w. Rule 8D of IT Rule, 1962. The assessee has claimed before the Id. CIT(A) that he was engaged in the business of trading in shares and securities and the provisions of the section 14A were not applicable to it. It was also submitted that as the assessee was engaged in the business of trading in shares and securities and the borrowed funds had been utilized for purchase of shares, therefore, interest paid on such

borrowed fund was treated as business expenses u/s. 36(1)(iii) of the act and accordingly, no disallowance u/s. 14A could be made in relation to interest expenditure. During the course of appellate proceedings before us, the ld. counsel has referred the decision of ITAT (Delhi) in the case of ACIT vs. Punjab National Bank vide ITA No. 1810/Del/2016 dated 08-04-2019. After referring the aforesaid decision, the ld. counsel has submitted that no addition in the case of the assessee u/s. 14A is sustainable stating that the assessee company has acquired shares for the purpose of liquidating those shares whenever the share price goes up in order to earn profit. The ld. authorized representative has also placed reliance on the decision of Honøble High Court of Punjab & Haryana in the case of Principal Commissioner of Income Tax vs. State Bank of Patiala and decision of Honøble Supreme Court in the case of Maxopp Investment Ltd. We have also gone through paper book filed by the ld. counsel comprising submission made before the ld. CIT(A) and copies of audited accounts of the assessee company. It is undisputed fact that assessee company was engaged in the business of trading in shares and securities as demonstrated from the schedule 9 to the profit and loss account statement for the year ended 31st March, 2014 placed in the paper book. At page 43 of the paper book, the assessee has also placed copy of decision of the Honøble High Court of Karnataka in the case of CCI Ltd. 20 taxmann.com 196 (Karnataka). We have perused the decision of Honøble High Court of Karnataka in CCI Ltd. vs. Jt.CIT 20 taxmann.com 196 (Kar) wherein it is held that when assessee had not retained shares with intention of earning dividend income and dividend income was incidental to his business of sale of shares, which remained unsold by assessee, it could not be said that expenditure incurring in

acquiring shares had to be apportioned to extent of dividend income and that should be disallowed under section 14. We have also perused the decision of the Honøble High Court of Punjab & Haryana in the case of Pr. CIT vs. State Bank of Patiala (2017) 78 taxmann.com and the Punjab and Haryana High Court has followed the judgment of the Honøble High Court of Karnataka in CCI Ltd. vs. Jt. CIT (2012) 20 taxmann.com 196. We consider that Honøble Supreme Court in the case of Maxopp Investment Ltd. Vs. CIT (2018) 91 taxmann.com 154 has considered the judgment in the case of Pr. CIT vs. State Bank of Patiala and in the case of CCI Ltd. vs. Jt. CIT for applicability of section 14A of the Act where the shares/stocks were purchased of a company for the purpose of gaining control over the said company or as ÷stock in tradeø. The Honøble Supreme court in the case of Maxopp Investment Ltd. vs. CIT has held that where the shares are held as ÷stock in tradeø the main purpose is to trade in those shares and earn profits therefrom, in such cases as well, if dividend is also earned though incidentally and it will trigger the applicability of section 14A of the Act and the expenditure in acquiring these shares will have to be apportioned. The relevant of the decision of the Honøble Supreme Court in the case of Maxopp Investment Ltd. vs. CIT. (2018) 91 taxmann.com 154 is reproduced as under:-

“31. We have given our thoughtful consideration to the argument of counsel for the parties on both sides, in the light of various judgments which have been cited before us, some of which have already been taken note of above.

32. In the first instance, it needs to be recognised 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 this Act". Axiomatically, 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. 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.

33. There is no quarrel in assigning this meaning to section 14A of the Act. In fact, all the High Courts, whether it is the Delhi High Court on the one hand or the Punjab and Haryana High Court on the other hand, have agreed in providing this interpretation to section 14A of the Act. The entire dispute is as to what interpretation is to be given to the words 'in relation to' in the given scenario, viz. where the dividend income on the shares is earned, though the dominant purpose for subscribing in those shares of the investee company was not to earn dividend. We have two scenarios in these sets of appeals. In one group of cases the main purpose for investing in shares was to gain control over the investee company. Other cases are those where the shares of investee company were held by the assesseees as stock-in-trade (i.e. as a business activity) and not as investment to earn dividends. In this context, it is to be examined as to whether the expenditure was incurred, in respective scenarios, in relation to the dividend income or not.

34. Having clarified the aforesaid position, the first and foremost issue that falls for consideration is as to whether the dominant purpose test, which is pressed into service by the assesseees would apply while interpreting Section 14A of the Act or we have to go by the theory of apportionment. We are of the opinion that the dominant purpose for which the investment into shares is made by an assessee may not be relevant. No doubt, the assessee like Maxopp Investment Limited may have made the investment in order to gain control of the investee company. However, that does not appear to be a relevant factor in determining the issue at hand. Fact remains that such dividend income is non-taxable. In this scenario, if expenditure is incurred on earning the dividend income, that much of the expenditure which is attributable to the dividend income has to be disallowed and cannot be treated as business expenditure. Keeping this objective behind Section 14A of the Act in mind, the said provision has to be interpreted, particularly, the word 'in relation to the income'¹ that does not form part of total income. Considered in this hue, the principle of apportionment of expenses comes into play as that is the principle which is engrained in Section 14A of the Act. This is so held in *Walfort Share & Stock Brokers (P.) Ltd.*, relevant passage whereof is already reproduced above, for the sake of continuity of discussion, we would like to quote the following few lines therefrom.

"The next phrase is, "in relation to income which does not form part of total income under the 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 14A..

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The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14A. "

35. The Delhi High Court, therefore, correctly observed that prior to introduction of Section 14A of the Act, the law was that when an assessee had a composite and indivisible business which had elements of both taxable and non-taxable income, the entire expenditure in respect of said business was deductible and, in such a case, the principle of apportionment of the expenditure relating to the non-taxable income did not apply. The principle of apportionment was made available only where the business was divisible. It is to find a cure to the aforesaid problem that the Legislature has not only inserted Section 14A by the Finance (Amendment) Act, 2001 but also made it retrospective, i.e., 1962 when the Income Tax Act itself came into force. The aforesaid intent was expressed loudly and clearly in the Memorandum explaining the provisions of the Finance Bill, 2001. We, thus, agree with the view taken by the Delhi High Court, and are not inclined to accept the opinion of Punjab & Haryana High Court which went by dominant purpose theory. The aforesaid reasoning would be applicable in cases where shares are held as investment in the investee company, may be for the purpose of having controlling interest therein. On that reasoning, appeals of Maxopp Investment Limited as well as similar cases where shares were purchased by the assesseees to have controlling interest in the investee companies have to fail and are, therefore, dismissed.

36. There is yet another aspect which still needs to be looked into. What happens when the shares are held as 'stock-in-trade' and not as 'investment', particularly, by the banks? On this specific aspect, CBDT has issued circular No. 18/2015 dated November 02, 2015.

37. This Circular has already been reproduced in Para 19 above. This Circular takes note of the judgment of this Court in *Nawanshahar* case wherein it is held that investments made by a

banking concern are part of the business or banking. Therefore, the income arises from such investments is attributable to business of banking falling under the head 'profits and gains of business and profession'. On that basis, the Circular contains the decision of the Board that no appeal would be filed on this ground by the officers of the Department and if the appeals are already filed, they should be withdrawn. A reading of this circular would make it clear that the issue was as to whether income by way of interest on securities shall be chargeable to income tax under the head 'income from other sources' or it is to fall under the head 'profits and gains of business and profession'. The Board, going by the decision of this Court in Nawanshahar case, clarified that it has to be treated as income falling under the head 'profits and gains of business and profession'. The Board also went to the extent of saying that this would not be limited only to co-operative societies/Banks claiming deduction under Section 80P(2)(a)(i) of the Act but would also be applicable to all banks/commercial banks, to which Banking Regulation Act, 1949 applies.

38. From this, Punjab and Haryana High Court pointed out that this 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 income the profit would be said to have accrued from investment. To this extent, the High Court may be correct. At the same time, we do not agree with the test of dominant intention applied by the Punjab and Haryana High Court, which we have already discarded. In that event, the question is as to on what basis those cases are to be decided where the shares of other companies are purchased by the assessee as 'stock-in-trade and not as 'investment'. We proceed to discuss this aspect hereinafter.

39 In those cases, where shares are held as stock-in-trade, the main purpose is to trade in those shares and earn profits therefrom. However, we are not concerned with those profits which would naturally be treated as 'income' under the head 'profits and gains from business and profession'. What happens is that, in the process, when the shares are held as 'stock-in-trade', certain dividend is also earned, though incidentally, which is also an income. However, by virtue of Section 10 (34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section 14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income as held in Walford Share & Stock Brokers (P.) Ltd. case. Therefore, to that extent, depending upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned.

40. We note from the facts in the State Bank of Patiala cases that the AO, while passing the assessment order, had already restricted the disallowance to the amount which was claimed as exempt income by applying the formula contained in Rule 8D of the Rules and holding that section 14A of the Act would be applicable. In spite of this exercise of apportionment of expenditure carried out by the AO, CIT(A) disallowed the entire deduction of expenditure. That view of the CIT(A) was clearly untenable and rightly set aside by the ITAT. Therefore, on facts, the Punjab and Haryana High Court has arrived at a correct conclusion by affirming the view of the ITAT, though we are not subscribing to the theory of dominant intention applied by the High Court. It is to be kept in mind that in those cases where shares are held as 'stock-in-trade', it becomes a business activity of the assessee to deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares by selling them to earn profits. The situation here is, therefore, different from the case like Maxopp Investment Ltd. where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the assessee and the assessee alone. Therefore, even at the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes up in order to earn profits. In the result, the appeals filed by the Revenue challenging the judgment of the Punjab and-Haryana High Court in State Bank of Patiala also fail, though law in this respect has been clarified hereinabove

41. Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, we also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the assessee, suo moto disallowance under Section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for purchasing the shares/making the investment in shares is to be examined by the AO.

42. Civil Appeal No. 1423 of 2015 is filed by M/s. Avon Cycles Limited, Ludhiana, wherein the AO had invoked section 14A of the Act read with Rule 8D of the Rules and apportioned the expenditure. The CIT(A) had set aside the disallowance, which view was upturned by the ITAT in the following words:

After considering the decision of the Honøble Supreme Court in the Maxopp case as cited above, it is clear that the principle of apportionment of the expenditure was applicable and the expenditure apportioned to the exempt income or income not eligible to tax was not allowable as a deduction. In view of the decision of the Honøble Supreme Court as supra, the provision of section 14A is applicable even when the shares are held as stock in trade though incidentally certain dividend income is earned, therefore, the contention of the Id. counsel about the applicability of the decision of the Co-ordinate Bench of the ITAT in the case of ACIT Vs. Punjab National Bank ITA No. 1810/Del/2016 is not acceptable. We consider that the decision of the Honøble Supreme Court in Maxopp Investment Ltd. vs. CIT has settled the law that relevant expenditure in case of exempt income has to be apportioned between taxable and non-taxable income. In the case of the assessee, the total exempt income earned during the year is Rs. 22,01,928/- as per note 10 attached to the profit and loss statement for the year ended 31st March, 2014 and share dividend account placed at page 42 of the paper book. We consider that Honøble Delhi High Court in the case of Joint Investment Pvt. Ltd. Vs. CIT (2015) 59 taxmann.com 295 held that disallowance u/s. 14A cannot exceed the actual exempt income. The ITAT

Ahmedabad in the cases of K. Ratanchand & CO. vs. ITO (2017) 83 taxmann.com 242 and Jivraj Tea Ltd. Vs. DCIT ITA No. 886/Ahd/2012 have also held that addition under section 14A cannot be more than exempt income. In the light of the decision of Honøble Supreme Court in the case of Maxopp Investment Ltd. and decision of Honøble Delhi High Court and ITAT Ahmedabad as cited above, we restrict the impugned disallowance to the extent of income of Rs. 2,21,928/- , therefore, appeal of the Revenue is partly allowed.

6. In the result, the appeal of the revenue is partly allowed.

Order pronounced in the open court on 01-10-2019

Sd/-
(MAHAVIR PRASAD)
JUDICIAL MEMBER
Ahmedabad : Dated 01/10/2019

Sd/-
(AMARJIT SINGH)
ACCOUNTANT MEMBER

आदेश कतलम अषत / Copy of Order Forwarded to:-

1. Assessee
2. Revenue
3. Concerned CIT
4. CIT (A)
5. DR, ITAT, Ahmedabad
6. Guard file.

By order/आदेश से,

उप/सहायक पंजीकार
आयकर अपीलअ अधकरण,
अहमदाबाद