IN THE INCOME TAX APPELLATE TRIBUNAL "G" BENCH, MUMBAI

BEFORE SHRI BR BASKARAN, AM AND SHRI ABY T. VARKEY, JM

आयकर अपील सं/ I.T.A. No.2169/Mum/2023
(**निर्धारण वर्ष** / Assessment Year: 2017-18)

DCIT, Central Circle-3(3) Room No. 1923, 19th Floor, Air India Building, Nariman Point, Mumbai.	**बनाम**/ Vs.	Welspun Steel Ltd Survey No. 650 & 652, Village Versamedi, Distt-Kutch, Anjar, Gujarat.
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. : AAACW5308G		
(अपीलार्थी **/Appellant**)	..	(प्रत्यर्थी / **Respondent**)

Assessee by:	Shri Madhur Agrawal/Shri Mani Jain
Revenue by:	Dr. Kishor Dhule (DR)

सुनवाई की तारीख / Date of Hearing: 01/02/2024
घोषणा की तारीख /Date of Pronouncement: 29/02/2024

आदेश / O R D E R

PER ABY T. VARKEY, JM:

This appeal has been preferred by the Revenue against the order dated 28.03.2023 passed u/s 250 of the Income-tax Act, 1961 [in short 'the Act'] by the Ld. Commissioner of Income-tax (Appeals), NFAC [in short 'CIT(A)'] for AY 2017-18.

2. Ground No. 1 of the appeal is against the Ld. CIT(A)'s action of deleting the disallowance of long-term and short-term capital loss arising upon sale of shares of M/s Welspun Energy Limited [in short 'WEL']. The facts of the case are that, the assessee is engaged in the business of manufacturing and trading of sponge iron, steel billets/Ingot and non-alloys rolled products. Vide order of the Hon'ble National Company Law Tribunal [in short 'NCLT'] dated 08.08.2017, M/s. Welspun Energy Pvt. Ltd. [in short 'WEPL'] and M/s. WS Alloy

Holding Pvt. Ltd. [in short 'WSAHPL'] stood amalgamated with M/s. Welspun Steel Ltd [in short 'WSL' or 'assessee'] from the appointed date 01.04.2016. The assessee, M/s WSL, is therefore the successor company of M/s. WEPL. The assessee accordingly filed its return of income u/s. 139(1) of the Act on 28.11.2017 declaring income at Rs.429,21,64,250/- which was later on revised to Rs. 472,53,77,990/-. The case of the assessee was originally selected for scrutiny by issue of notice u/s 143(2) of the Act dated 10.09.2018. The proceedings however stood *abated* as a consequence of the search action u/s 132 conducted on 30.06.2017 upon the Welspun Group. Pursuant thereto, notice u/s 153A of the Act was issued on 01.08.2018. In response, the assessee filed its return of income on 24.08.2018 declaring income of Rs.472,53,77,990/-.

3. From the facts on record, it is noted that the WEPL (which stood merged with the assessee) had claimed capital loss of Rs.423 crore on sale of shares of M/s. Welspun Energy Chhattisgarh Limited [in short 'WECL'] to its related entity, M/s. Solarsys Infra Projects Pvt. Ltd. [in short 'SIPPL']. It is noted that WEPL had sold the investment of Rs.686 crore held in WECL to SIPPL for total consideration of Rs.300 crore on 29.03.2017, which had yielded the impugned loss. The said loss *inter alia* comprised of long-term capital loss (*after indexation*) of Rs. 249 crore and short-term capital loss of Rs. 178 crores. Since WSL was the successor company to WEPL, the aggregate capital loss was claimed by assessee M/s WSL in the relevant AY 2017-18.

4. The details of the investment held by WEPL in WECL is noted to comprise of the following Optionally Convertible Preference Shares [in short 'OCPS'] of Rs.686 crores.

Instrument	**Date of Investment**	**No. of shares**	**Amount (Rs. in crore)**
OCPS	25.10.2014	37,50,00,000	375
OCPS	21.11.2016	30,52,00,000	305.20
OCPS	17.03.2017	54,50,000	5.40
Total		**68,57,50,000**	**686**

5. The genesis of the investment made in OCPS was that, WEPL had initially paid sum of Rs.375 crores to its wholly owned subsidiary, WECL on 16.10.2014, against which WECL issued OCPS. WECL, in turn, had paid Rs.375 crores to its wholly owned subsidiary, Welspun Energy Resources Pvt Ltd [in short 'WERPL'] and a further sum of Rs. 3 crores on 21.10.2014. Out of the total sum of Rs.378 crores so received, WERPL had issued OCPS of Rs.300 crores to WECL. WERPL had thereafter advanced interest-free loan of Rs.375 crores back to WEPL. Later on, vide scheme of amalgamation approved by the Hon'ble Bombay High Court vide order dated 30.01.2015, WERPL stood merged with WEPL from the appointed date 01.01.2015. It is noted that, post the amalgamation, the value of investment held by WEPL in OCPS of WECL for Rs.375 crores continued to remain the same. However, as a consequence of the amalgamation, ordinarily shares of amalgamated company, WEPL was required to be issued to the shareholders of WERPL i.e., WECL. However, in view of the prohibition set out in section 19 of the Companies Act, 2013 which *debars any holding company from allotting shares to its subsidiary*, the OCPS held by WECL in WERPL

stood cancelled resulting in creation of Capital Reserve of Rs.300.5 crores in the books of the amalgamated holding company i.e., WEPL. Correspondingly, WECL was required to account for loss of equivalent amount of Rs.300.5 crores arising upon extinguishment of the OCPS held by it in WERPL, as a consequence of the amalgamation. It is noted that, the said loss of Rs.300.5 crores were disallowed by WECL voluntarily in its return of income filed for AY 2015-16 and was not carried forward as well.

6. Subsequently, WEPL is noted to have again advanced loans aggregating to Rs.305.20 crores to WECL on different dates during the period from September 2014 to November 2016. It is noted that, majority of the loan viz., Rs.296.64 crores were advanced prior to 31st March, 2016. These loans received by WECL from its holding company was utilized for making downstream investments in three (3) project SPVs namely (i) M/s. Welspun Energy UP Pvt. Ltd. (ii) M/s. Welspun Energy MP Pvt. Ltd. and (iii) M/s. Welspun Energy Anuppur Pvt. Ltd. by combination of equity infusion and interest free loans. Later on, in the month of November 2016, these loans provided by WEPL to WECL for funding the project SPVs were converted into OCPS. WEPL also invested further sum of Rs.5.40 cr on 17.03.2017 in OCPS of WECL. Subsequently, vide Share Purchase Agreement [in short 'SPA'] dated 29.03.2017, WEPL sold the entire OCPS of Rs.686 crores (375 + 305.20 +5.40) held in WECL to SIPPL for an aggregate consideration of Rs.300 crores. It is noted that, the sale consideration agreed upon was based on the valuation report obtained from a

merchant banker. Later on, in April/May 2019, WECL (*which was now owned by SIPPL*) had sold its stake in the three project SPVs to Adani Infra (India) Ltd [in short 'Adani'] for an aggregate consideration of Rs.295 crores.

7. Having regard to the above facts, the AO in the course of assessment vide show-cause notice dated 22.11.2019 had required the assessee to explain as to why the total capital loss claimed on sale of shares of WECL amounting to Rs. 423 crores should not be disallowed. According to the AO, the aforesaid loss was an artificial loss created on paper and thus should not be allowed to the assessee. In response, the assessee had furnished its detailed objections which has been extensively reproduced by the AO at Para 6.2 of the impugned assessment order. It is noted that, according to AO, the initial funds of Rs.375 crores were rotated from WEPL to WECL to WERPL and back to WEPL on the same date but the colour and nature of the funds changed at each layer. Referring to the statement of Shri Rajesh Verma, senior Vice President (Accounts) of WEPL recorded u/s 132(4) of the Act on 31.03.2017, the AO noted that he was unable to explain the business rationale for undertaking such circular movement of funds. According to AO, this circular movement of funds and thereafter, the amalgamation of WERPL into WEPL was pre-planned to create an imaginary loss based on accounting jugglery. The AO observed that there was no proper justification given for the scheme of merger between WERPL and WEPL and that the rationale mentioned in the scheme was not satisfactory. The AO was therefore of the view

that the scheme of amalgamation undertaken by and between WEPL and WERPL in AY 2015-16 was not tax-neutral and that the notional loss created as result of this amalgamation was contrary to the taxation principles.

8. The AO further noted that WEPL had already entered into a MOU with Adani Group for sale of shares of WECL for which it had received interest-free advance of Rs.422 crores in October 2014 and therefore in his view, the intention to sell the stake in WECL was there from the beginning. However, as the transaction was not completed during the year, the shares of WECL was transferred to SIPPL by WEPL, all of which under same management, to create an artificial loss to reduce its capital gain liability. The AO was of the view that, the effective investment of WECL in three SPVs was only Rs.300 crores and that WECL ultimately sold the investment in three SPVs to Adani Infra (India) Limited in 2019 for Rs. 295 crores. In AO's view therefore, if the real transaction was seen, there was an overall loss of only Rs.5 crores whereas, the assessee claimed an higher artificial loss by taking refuge to the earlier investment of Rs.375 crores which, according to him, was only on paper. The AO accordingly held that there was enough direct and circumstantial evidence surrounding the transaction, which showed that it was a colorable device deployed by the assessee to create a notional loss. The AO thus disregarded the transaction and disallowed the loss. For doing so, the AO referred to the decisions of the Hon'ble Apex Court in the cases of Sumati Dayal Vs CIT (214 ITR 801), Durgaprasad More (82 ITR 540), McDowell &

Co. Ltd Vs CTO (154 ITR 148) and Vodafone International Holdings BV vs. UOI (204 Taxman 408). The AO also relied upon the decision of Hon'ble Karnataka High Court in the case of Wipro Ltd (50 taxmann.com 421) for disallowing the impugned capital loss.

9. Being aggrieved by the above order of the AO, the assessee preferred an appeal before the Ld. CIT(A) who was pleased to delete the disallowance of the impugned capital loss. Now, the Revenue is in appeal before us.

10. Assailing the action of the Ld. CIT(A), the Ld. DR vehemently supported the order of the AO. The Ld. DR narrated the entire timeline of events and submitted that the assessee had created this artificial loss through an elaborate scheme of rotation of funds and restructuring of group companies. Firstly, the Ld. DR disputed the veracity of the original investment of Rs.375 crores. He reiterated the observations of the AO and argued that the circular movement of funds and the scheme of amalgamation as implemented by the assessee in AY 2015-16 was not tax-neutral and therefore the loss created because of the scheme of merger was notional. He also argued that this original cost of acquisition of the first tranche of OCPS of Rs.375 crores was only on paper and thus was to be ignored. On the aspect of the subsequent sale of investment in WECL to SIPPL, the Ld. DR laid much emphasis on the fact that, when Adani had already entered into an MOU to acquire WECL for Rs. 422 crores, then the sale of shares of WECL to SIPPL for Rs.300 crores was an eye-wash. He submitted that the transactions were conducted between related parties only to generate

this loss. The Ld. DR further referred to the statement of Shri Rajesh Verma and argued that when the senior accounts head of the assessee was unable to substantiate the business rationale behind this transaction, it lends support to the AO's case that this entire scheme was undertaken with the sole intent to avoid tax. He accordingly urged that the order of Ld. CIT(A) be reversed and that of the AO be restored.

11. Per contra, the Ld. AR appearing for the assessee, supported the findings of the Ld. CIT(A). He pointed out that all the relevant details relating to the impugned transactions was furnished before the AO which showed that they were legitimate business transactions carried out in the regular course of business and supported by material evidence. Taking us through the order of the Ld. CIT(A), the Ld. AR showed us that the assessee had explained the business rationale behind the infusion of funds into WERPL through WECL and the subsequent merger of WERPL with WEPL. He further contended that, the reliance placed by the Revenue on the statement of Shri Rajesh Verma was misplaced for twin reasons, viz.; (a) he was only a senior accounts staff and a non-managerial person and thus he could not be expected to explain the business rationale behind the decision which is taken in closed doors after much deliberation by the management and (b) he had only averred that he is unable to answer these questions and that nowhere he had stated anything adverse or admitted to any wrong doing. He further emphasized on the fact that, the Revenue was under mistaken assumption of fact that the loss arising because of the merger

of WERPL with WEPL was claimed by the assessee. He particularly invited our attention to Para 10.21 of the Ld. CIT(A)'s order wherein it was noted that the loss of Rs.300.5 crores debited by WECL as a consequence of this merger had been disallowed voluntarily and also not carried forward. The Ld. AR further contended that, the income-tax assessment of WEPL for AY 2015-16, was simultaneously completed by the same AO u/s 153A/143(3) of the Act and he showed us that no adverse inference was drawn either in respect of these transactions between WEPL, WECL and WERPL or in relation to this merger. The AO had neither held the scheme of amalgamation to be sham or not tax-neutral in the income-tax assessment completed for AY 2015-16. The Ld. AR accordingly submitted that, the AO was completely unjustified in disputing the transactions and scheme of amalgamation undertaken in AY 2015-16 in the income-tax assessment for the relevant AY 2017-18.

12. The Ld. AR further submitted that, indeed WEPL had entered into an MOU with Adani for sale of shares of WECL in October 2014 but the transaction was never completed. He narrated the entire market dynamics, which occurred between 2014 to 2019, to show that the MOU was signed when the business prospects were bright but later on, the business prospects became weak. Also, the assessee had suffered set back due to the order of the National Green Tribunal passed in December 2016 which had set aside the environmental clearances earlier granted to the subsidiaries of WECL. As a consequence, the valuation of WECL was adversely affected. The Ld. AR supported the

sale consideration agreed between the related parties i.e., WEPL and SIPPL with reference to the report obtained from an independent merchant banker. He also showed us that ultimately, the investment in WECL had not been sold to Adani, as initially agreed. Instead, the investment in the three SPVs were sold to Adani in April 2019 for Rs.295 crores which was significantly different from the initial MOU value and rather it supported the valuation of Rs.300 crores which was agreed between WEPL and SIPPL. The Ld. AR accordingly submitted that the Ld. CIT(A) had rightly held the impugned capital loss to be genuine and thus his order does not call for any interference.

13. We have heard both the parties and perused the material placed before us. The details of the capital loss claimed by the assessee is noted to be as follows :-

Instrument	**Date of Investment**	**No. of shares**	**Amount (Rs. in Cr)**	**Short Term/ Long Term Capital Loss**	**Indexed COA (Rs. in Cr)**	**Sale Consid-eration**	**Gain/ (Loss) (Rs. in Cr)**
OCPS	25.10.2014	37,50,00,000	375	Long Term	412	164	(248)
OCPS	21.11.2016	30,52,00,000	305.20	Long Term	305	134	(172)
OCPS	17.03.2017	54,50,000	5.40	Short Term	5	2	(3)
Total		**68,57,50,000**	**686**		**723**	**300**	**(423)**

14. The above computation comprises of three material components viz., (i) cost of acquisition of first tranche of OCPS for Rs.375 crores, (ii) cost of acquisition of second tranche of OCPS for Rs.310.60 crores [Rs.305.20 crores + Rs.5.40 crores], and (iii) sale consideration of Rs.300 crores, which after indexation resulted in the impugned aggregate capital loss of Rs.423 crores. It is noted that, the AO has held that this entire transaction of issuing OCPS, scheme of merger

and subsequent sale of OCPS was a pre-arranged colorable device undertaken with the sole intent to create an artificial loss and avoid tax.

15. For arriving at the above finding, the AO is noted to have primarily doubted the initial investment of Rs.375 crores made in OCPS of WECL by WEPL, holding it to be merely on paper. The AO as well as the Ld. DR has heavily stressed on the fact that, the investment so made was routed through wholly owned subsidiaries and received back by WEPL on the same date, which, according to them, showed that the transaction was not genuine. Although at first blush, this circular movement of funds did appear to be unnatural but later on upon being apprised of the rationale behind the same, it is noted that neither did this transfer of funds result in creation of any loss and that there was indeed commercial rationale behind doing so, which we have discussed in the succeeding paragraph. Although the funds were routed amongst the group entities but the character and color of funds changed in each leg creating different rights and obligations *inter-se* the parties and hence, it was not a simple circular movement of funds as was alleged by the AO.

16. From the facts placed before us, it is noted that WEPL was engaged in the business of engineering, procurement and construction business commonly known as EPC business. The said company was carrying on thermal energy business and renewable energy business through its subsidiaries, WECL and Welspun Renewables Energy Private Limited [in short 'WREPL'] respectively. It is therefore observed that WECL was the vehicle through which WEPL was

carrying on coal based thermal energy business. The Ld. AR explained that, thermal energy business is commonly project based and therefore separate and independent SPVs are floated to bid and procure tenders for setting up of thermal energy plants at different locations across different states. The rationale for doing so is that, separate SPVs would enable clear demarcation of financial transactions relating to each project. Further, the assessee group would be able to easily identify and bring in investor / partner in relation to any specific project, for which it seeks so and this would ensure that all parties involved have visibility into the project's financial activities. It is accordingly noted that, apart from WERPL, WECL had also floated three other SPVs namely; (i) M/s. Welspun Energy UP Pvt. Ltd. (ii) M/s. Welspun Energy MP Pvt. Ltd. and (iii) M/s. Welspun Energy Anuppur Pvt. Ltd. and each of these entities were meant to pursue and bid for separate tenders / thermal power projects. The Ld. AR also explained that, while submitting the bids, the concerned SPV is required to demonstrate its financial capability for undertaking the said project. Since the size of these projects are generally in excess of several hundred crores, the SPVs are accordingly funded suitably by the holding company to demonstrate their financial abilities and meet the net worth criteria, if any, set out in the bidding documents. It was in this background that, WEPL had first paid sum of Rs.375 crores to WECL by subscribing to their OCPS, which in turn, had funded a SPV, WERPL again by way of OCPS. These acts of issuing OCPS is therefore noted to have created legal rights and obligations between the parties, which cannot be arbitrarily disregarded. The primary

business rationale for the capital infusion in WERPL through WECL was to form an SPV to undertake specific project and ensure that the said SPV would meet the expected net-worth criteria as a part of performance qualifications. The Ld. AR further pointed out that, until the project was obtained and undertaken, there was no purpose for this SPV to keep the funds lying idle and therefore the same was advanced back by way of interest free loan to WEPL. The rationale for giving interest free loan was that, once any project was awarded to WERPL, then WEPL would repay the monies back to WERPL for undertaking the said project. Until then, the monies would be purposefully deployed within the group.

17. Having regard to the foregoing, we find merit in the submission of the Ld. AR that the acts involving issuance of OCPS by WECL and WERPL and thereafter the loan given by WERPL to WEPL was based on business prudence to create specific rights and obligations amongst the entities in the regular course of business. Moreover, as rightly pointed out by Ld. AR that, the movement of funds amongst the entities did not result in any creation of tax loss or tax claim and therefore there was no reason to dispute the same. In our view therefore, this sequence of transactions cannot be simply stated as sham.

18. The Revenue is further noted to have linked the above movement of funds with the subsequent action involving merger of WERPL with WEPL, which according to them, resulted in creation of artificial loss rendering the scheme of amalgamation to be non-tax

neutral. The Revenue questioned the timing of issuance of OCPS and the subsequent merger. According to the Ld. CIT, DR, only because the Hon'ble High Court sanctioned the scheme would not ipso facto render the amalgamation to be tax-neutral and enable the assessee to avail the artificial loss so created. For this, the Ld. CIT, DR invited our attention to the order of the Hon'ble Bombay High Court dated 30.01.2015 approving the scheme of amalgamation wherein the Court had inter-alia observed that, all the tax issues arising out of the scheme of amalgamation will have to be met and answered in accordance with law. The Revenue has also questioned the rationale for amalgamating WERPL with WEPL. According to AO, WERPL could have been easily merged with WECL rather than merging it with WEPL. The AO is noted to have observed that, there was various other alternatives to wind up WERPL which would not have resulted in this notional loss and that the assessee could have chosen to avoid this scheme of amalgamation altogether. The AO is therefore noted to have alleged that the scheme of merger was a colorable device meant solely for avoidance of tax.

19. Countering the above, the Ld. AR firstly pointed out that, the foundational premise of this allegation of the Revenue is based on incorrect assumption of fact. The Ld. AR took us through the scheme of arrangement and explained the entries passed in the books of accounts to give effect to the terms sanctioned by the Hon'ble High Court. The Ld. AR showed us that, the only loss, which was provided for, pursuant to the amalgamation, was the loss arising upon

extinguishment of OCPS held by WECL in WERPL. He explained that, by operation of law i.e. Section 19 of the Companies Act, 2013, WECL could not be issued shares of its holding company i.e. WEPL in lieu of the OCPS held in WERPL and hence the entire investment value was provided for as a loss, as a consequence of the merger. The loss of Rs.300.50 crores, which was debited in the Profit & Loss Account of WECL, was shown to have been disallowed voluntarily and the said capital loss was not even carried forward by WECL. The relevant findings of the Ld. CIT(A) in this regard are noted to be as under: -

> "10.21 Also, on perusal of the submissions made by the assessee, it is also noticed that due to merger of WERPL with WEPL, the loss suffered by WECL during the FY 2014-15 was not claimed or carried forward by WECL while filing its return of income for the FY 2014-15. It is seen that WECL, while debiting an expense of Rs. 300,05,00,000/- as "loss on cancellation of OCPS on merger', has re-cognized this loss as capital loss and the same has not been claimed as a deduction. This loss has also not been carried forward. The AO has completely ignored this fact."

20. Before us, the Ld. CIT, DR was unable to controvert the above finding nor was he able to show that this loss had been set-off or claimed by WECL in any subsequent year. Apart from the foregoing, the Revenue was unable to point out any other purported loss created in this scheme of amalgamation, which according to AO, rendered the merger to be non-tax neutral. We therefore note that there was no

artificial loss created or claimed or carried forward pursuant to this scheme of amalgamation and hence the genesis of dispute raised by the AO doubting the scheme of merger and suspecting it to be done only to create artificial loss is noted to be non-existent and hence factually unfounded.

21. The Ld. AR further showed us that, the linkage of the circular transactions with the scheme of amalgamation was also of no relevance. He explained that, even if hypothetically, had WERPL not given back the loan to WEPL and rather retained the monies received from WECL with it or used it to set-up any power project, still the entries passed pursuant to the merger, would have been the same. Still, the OCPS held by WECL in WERPL would have been extinguished because of operation of law i.e. Section 19 of Companies Act, 2013 and that the value of investments held by WEPL in WECL of Rs.375 crores would have continued to remain the same. Having regard to the foregoing explanation, we find force in the Ld. AR’s contention that the sequence of transactions between WEPL, WECL and WERPL had no linkage with the scheme of amalgamation because of which any undue tax advantage was obtained by any of these three entities.

22. We also find merit in the Ld. AR’s submissions that, the AO was unjustified in suggesting alternative modes of winding up WERPL as opposed to its merger with WEPL. According to us, this particular objection of the Revenue is untenable for the foremost reason that every assessee is entitled to arrange for its affairs in the manner, which it deems to be most suitable. The AO cannot dictate the assessee as to

how to manage or run his business affairs. As long as the assessee is conducting its business affairs within the legal framework, it is at liberty to manage and utilize its resources according to its own prudence and skill. The AO is noted to have blurred the difference between legitimate tax planning vs tax avoidance. As observed by Hon'ble Supreme Court in the case of **Vodafone International Holdings B.V. v. Union of India (17 taxmann.com 202)**, the object of tax planning, obviously, is to save tax. Broadly speaking, it may be defined as an exercise, which a taxpayer undertakes, with a view to meet his tax obligations in an orderly, systematic, disciplined and scientific manner. The means which he adopts for reducing his tax burdens have to be legitimate and lawful and the transactions which he enters into have to be bona fide genuine. In this context, the following observations of the Hon'ble Supreme Court in **CIT v. B.M. Kharwar [1969] 72 ITR 603(SC)** can aptly be quoted, which are as follows:

> "It is now well-settled that taxing authorities are not entitled to ignore the legal character of the transaction which is the source of the receipt and to proceed on what they regard as the substance of the matter. The taxing authority is entitled to and indeed is bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device and legal relationship it is open to the taxing authorities to unravel the device and determine the true character of the relationship. But the legal effect of the transaction cannot be displaced by probing into the substance of the transaction".

23. Having regard to the above legal principle, in the case before us, WERPL had merged with WEPL. Since the shareholder of WERPL i.e. WECL was a subsidiary of WEPL, Section 19 of Companies Act, 2013 prohibited the holding company to issue its shares to its subsidiary company. Accordingly, the OCPS held by WECL in WERPL was extinguished resulting in provision of loss in the books of WECL. Similarly, since WEPL could not issue shares in lieu of the OCPS held by WECL in WERPL, it correspondingly resulted in creation of equivalent capital reserve. This effect to the scheme of merger and entries passed in the books of accounts is noted to be a consequence of operation of law i.e., Section 19 of Companies Act, 2013 and hence it cannot be viewed adversely. Only because the consequence following from this scheme of merger and operation of law resulted in a benefit to the entities involved cannot be straitjacketed as a colorable device.

24. We now proceed to consider the aspect of lack of commercial rationale behind the scheme of amalgamation raised by the Revenue. In the facts before us, WEPL was the flagship company engaged in EPC business and it was also involved in thermal energy business through its subsidiary WECL, which in turn held several project SPVs, with WERPL being one of them. Admittedly WEPL is noted to have funded WERPL through WECL. However, since the project which it intended to bid through WERPL did not go through, it was decided to wind up WERPL and merging it with WEPL was considered to be more prudent in their view amongst the other alternatives available.

The Ld. AR has explained the commercial rationale for merging WERPL with WEPL and not WECL, as suggested by AO. The Ld. AR pointed out that, WEPL did not intend to involve WECL in this scheme of amalgamation for the primary reason that WECL was already a subject matter of interest for an intended buyer i.e. Adani for which WEPL had already entered into an MOU. Hence involving WECL in the scheme would have complicated the deal with Adani, particularly when WERPL was unable to obtain any intended thermal project, for which it was formed. Also, although in income-tax laws, the merger of WERPL into WEPL or WECL was tax neutral, but the scheme of merger with WEPL resulted in better restructuring and enhancement of overall net worth of the ultimate parent entity which further assisted in meeting performance qualifications to bid for power projects. Having regard to the foregoing explanation, it is noted that the scheme of merger cannot be alleged to lack commercial rationale.

25. We also note that the scheme of merger placed before the Hon'ble High Court contained the business rationale, which was never disputed by any statutory authorities, at the material time when the scheme was sanctioned. Also, no such adverse finding was rendered by the AO in the income-tax assessment completed u/s 153A/143(3) for AY 2015-16 i.e. the year of amalgamation, copy of which is found placed at Pages 84 to 93 of Paper-book. Hence, according to us, the allegation now being levelled that the scheme undertaken in AY 2015-16 was a colorable device, that too in the income-tax assessment for AY 2017-18, cannot be entertained. Further, as noted above, there was

no undue tax benefit availed by this scheme as the purported loss being referred to by the AO had already been disallowed by WECL and therefore the allegation of tax avoidance is noted to have no legs to stand on. The Ld. CIT(A) is also noted to have analyzed the scheme of amalgamation from all angles and held that there was no adverse tax implication or undue tax benefit arising therefrom. The relevant findings of Ld. CIT(A), as noted by us, are as follows: -

> "10.15 For this we need to further analyse the merger and amalgamation which took place between WEPL and WERPL. It is seen that a result of the merger, the assets and liabilities of WERPL became the assets and liabilities of WEPL. As per section 47(vi) of the Act, such transaction is not regarded as a transfer and hence not liable for tax. The said section is reproduced below:
>
> Clause (vi) of section provides' as follows:
>
> > "(vi) any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company,"
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> According to the AO, as per Para 6.1.4 of his order, the asset of WERPL was the loan of Rs. 375 crore which it had advanced to WEPL. Also, as per Para 6.1.6 of the assessment order, the liability of WERPL was Rs. 78.87 crore which was transferred to WEPL. Further, since WEPL could not issue shares to WECL, as a consequence of the merger, in view of section 19 of the Companies Act, a Capital Reserve of Rs. 300.05 crore was created by WEPL for AY 2015-16. Moreover, it is also seen that

assessment of WEPL for AY 2015-16 u/s 153A r.w.s 143(3) was completed on 30.12.2019 and no adverse inference in respect of these transactions has been drawn.

10.16 It is clear that the Capital Reserve had to be created as the assessee was the ultimate holding company of WERPL and no shares were issued by the assessee to the shareholders of WERPL i.e WECL as consideration for the merger in view of section 19 of the Companies Act 2013 which prohibits any holding company from allotting any shares to its subsidiary company. The said reserve was a reserve of capital nature and not a benefit or a perquisite or advantage of any kind accruing to the assessee and thus is not taxable in hands of the assessee.

10.17 As a next step, one would like to examine the applicability of section 28(iv) of the Act to this capital reserve.

10.17.1 In this regard, the provisions of section 28(iv) of the Act, are reproduced herein below:

"28 The following income shall be chargeable to income-tax under the head 'Profit and gains of business or profession,-

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(iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of profession."

10.17.2 Section 28(iv) of the Act specifies the following conditions which need to be satisfied before making any addition which are as under:

(i) there must be benefit or perquisite;

(ii) it must arise out of the business or profession carried on by the recipient, and

(iii) it must be revenue in nature seen ”

10.17.3 In the instant case, it is noticed that no benefit or perquisite is arising out of the scheme of amalgamation. The assessee was indirectly holding or in other words was the ultimate holding company having the shares of WERPL through its 100% subsidiary which after the amalgamation ted to the direct ownership of the assets in the assessee’s name. In the whole process, the assessee has neither become richer nor poorer. If any benefit or perquisite does not arise from the business or profession carried on by the assessee, the provisions of Section 28(iv) in any case cannot be applied. it is evident that the intention of the Legislature is not to apply the provisions of Section 28(iv) to a case where there is increase in the general reserves arising due to recording of the shares in the balance sheet of the assessee at their market value.

10.17.4 Further, it is also observed that a book entry recording a reserve is a consequence of the amalgamation, which is required to be passed for the limited purpose of balancing the accounts based on the double entry system employed and cannot give rise to any benefit or perquisite in the course of the business. The only relationship between the two companies i.e WEPL and WERPL was that of indirect holding between them. In this factual background, it cannot be said that the amalgamation reserve arose out of any business activity of the assessee. Scheme of Amalgamation cannot also be regarded as an adventure in the nature of trade. Thus; the reserve created on account of amalgamation is capital in nature and cannot be said

to be created on account of regular business activity; Similar view has been taken by the Hon'ble Madras High Court in the case of CIT vs Stads. Ltd., (2015) 373 ITR 313 (Mad.) in which in para 11 it was held as under: -

> "A plain reading of the above said provision makes it clear that the amount reflected in the balance sheet of the assessee under the head 'reserves and surplus" cannot be treated as a benefit or perquisite arising from business or exercise of profession. The difference amount post amalgamation was the amalgamation reserve and it could not he said that it is out of normal transaction of the business."

10.17.5 Further Hon'ble ITAT, Kolkata in the case of ITO vs Shreyans investments Private Limited 141 ITD 672 (Kolkata-Tribunal) relying on the decision of the Hon'ble Bombay High Court in the case of Mahindra and Mahindra 261 ITR 501 (Bom) had taken a view that reserve arising out of amalgamation cannot be treated as income under section 28(iv) of the Income-Tax Act, 1961. The relevant extracts of the said decision are as under:

……

10.18 Further in order to analyse the applicability of section 56 of the Act in respect of the assets of WERPL acquired by WEPL by way of merger, it is seen that section 56(2)(x)(c) was brought into the scheme of the Act only w.e.f 01.04.2018 and is hence applicable only from AY 2018-19 onwards, while the case of the assessee pertains to AY 2017-18.

10.19 Furthermore, it is also pertinent to analyse the applicability of section 115JB of the Act to this transaction of amalgamation. It is evident that the capital reserve does not fall within the definition of 'Income' under Section 2(24) of Income Tax Act, 1961 and when a receipt is not on in the character of income it cannot form part of the book profit under Section 115JB of the Act, 1961. The same was held by Hon'ble Calcutta High Court in the case of PCIT vs. Ankit Metal and Power Ltd., (109 Taxmann.com 93) and by the Hon'ble Mumbai ITAT in case of Batliboi Limited Vs DCIT (ITAT Mumbai) ITA No. 5428/Mum/2015. In view of the above since the capital reserve, which arose in amalgamation, is not in nature of income and is not a revaluation reserve, the same cannot be included in book profit it u/s 115JB of the Act.

10.20 Further, as regards the cessation of liability in respect of the loan of Rs. 375 crore taken from WERPL by WEPL, owing to the merger, the assessee has explained: that the: same has been neutralized by the corresponding asset being taken over by WEPL. With regard to waiver of 'term loan' or any other loan in contrast to 'working capital loan', it was held as not chargeable to tax under section 41(1) in Mahindra & Mahindra Ltd. v. CIT [2003] 128 Taxman 394/261 ITR 501 (Bom.): The Apex Court affirmed the decision of the Bombay High Court recently which is reported in Commissioner v. Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32/255 Taxman 305. Also, the Apex Court held that for applying section 28(iv) the benefit must have been received by the assessee in some other form rather than in shape of money. In this case, the loan was not a trading liability and as such not chargeable to tax u/s 41(1). Further, the loan

was received as cash receipt and in case of its waiver, section 28(iv) was not applicable.

10.21 Also, on perusal of the submissions made by the assessee, it is also noticed that due to merger of WERPL with WEPL, the loss suffered by WECL during the FY 2014-15 was not claimed or carried forward by WECL while filing its return of income for the FY 2014-15. It is seen that WECL, while debiting an expense of Rs. 300,05,00,000/- as "loss on cancellation of OCPS on merger', has recognised this loss as capital loss and the same has not been claimed as a deduction. This loss has also not been carried forward. The AO has completely ignored this fact.

10.22 In any case all the above transactions between WEPL, WECL and WERPL involving the sum of Rs. 375 crore and also the merger between WEPL and WERPL took place in the FY 2014-15 relevant to the AY 2015-16 and even if any bogus loss has been created, the same will pertain to AY 2015-16 and not AY 2017-18. Further, perusal of the assessment order dated 30.12.2019 for AY 2015-16 of WEPL shows that it is not the case that any such loss has been claimed by the assessee in AY 2015-16 or the AO has disallowed any such loss or has made any such addition in AY 2015-16.

10.23 Therefore, the claim of the x that such bogus loss has been created by the assessee as a result of such transactions 'and subsequent merger does not hold ground. The transactions have been analysed in the context of the relevant sections of the Income Tax Act 1961 but no adverse inference can be drawn. It is pertinent to point out that no such attempt has been made by the AO except for jumping to the conclusion that the assessee entered into transactions which are a colourable device with the

> intention to create a notional loss for evading tax and set off with capital gains earned during the year…"

26. Before us, the Ld. CIT, DR appearing for the Revenue was unable to point out any infirmity or error in the above analysis undertaken by the Ld. CIT(A). Now, we come to the statement of Mr. Rajesh Verma, which forms the main basis of the AO as well as Ld. CIT, DR, to justify their contention that the scheme of merger between WEPL and WERPL lacked commercial rationale. Having perused the statement of Mr. Rajesh Verma, which has been extracted at Pages 14 to 18 of assessment order, we note that the concerned person never admitted to any tax avoidance or stated anything incriminating. Rather, he pleaded ignorance and stated that he was unaware about the commercial rationale for undertaking this transaction. The Ld. AR has pointed out that, Mr. Rajesh Verma held the designation of Senior Vice President (Accounts) and was therefore involved in accounting work of the WEPL. Since Mr. Rajesh Verma was not a part of the Board of Directors or senior management of WEPL who are in-charge of taking strategic business decisions, he was unable to answer the question posed by the Investigating authority. Having regard to the foregoing facts, we thus find ourselves to be in agreement with the following findings of the Ld. CIT(A) negating the reliance placed by the AO upon the statement of Mr. Rajesh Verma.

> "10.12 …..The AO has perhaps placed too much reliance on the statement of Sh. Rajesh Verma, employee of WEPL, who could not explain the business rationale behind these transactions and also who could not explain the business rationale behind the

> amalgamation. The fact remains that he has not admitted anything adverse regarding these transactions. It is not the case that he admitted that these transactions were sham transactions to create artificial losses."

27. Overall, we also find merit in the alternate contention of the assessee that, the scheme of amalgamation between WEPL and WERPL was made effective from appointed date 01.01.2015 and that all the entries giving effect to the said scheme was passed and accounted for in the books of AY 2015-16. The income-tax assessment of the assessee & WECL for AY 2015-16 had been framed by the same AO u/s 153A/143(3) of the Act along with the impugned income-tax assessment for AY 2017-18. If the AO was of the view that the scheme of merger was non-tax neutral or intended to disregard the entries passed pursuant thereto, then such finding ought to have been rendered in the income-tax assessment for AY 2015-16. However, it is not the case that any such finding has been made in the income-tax assessment completed u/s 153A/143(3) for AY 2015-16 or that any addition / disallowance on account of the purported loss artificially created in AY 2015-16 was made by the AO. We thus find ourselves in agreement with the following findings of the Ld. CIT(A) :-

> "10.23 …As already mentioned above, the relevant transactions between WEPL, WECL and WERPL involving the sum of RS. crore and also the merger between WEPL and WERPL pertain to FY, 2014-15 relevant to AY 2015-16. So if a case for any disallowance/addition has to be made, it is to be made in the relevant AY 2015-16. A perusal of the assessment

> order for AY 2015-16 of WEPL shows that no such disallowance/addition has been made by the AO in its case for AY 2015-16. In the absence of any such disallowance/addition for AY 2015-16, the conclusion drawn by the AO that the bogus loss has been set-off against the capital gains earned in AY 2017-18 is far fetched and incorrect. The facts do not indicate any such loss having been created in AY 2015-16 when these transactions took place or any such loss having been carried forward to AY 2017-18 for being set-off against capital gains earned in AY 2017-18."

28. For the above reasons, we therefore uphold the findings of the Ld. CIT(A) that, the acts involving issuance of OCPS of Rs.375 crores in October 2014, and the subsequent scheme of merger undertaken in AY 2015-16; was neither a colorable device nor did it result in creation of any artificial loss. Accordingly, the cost of OCPS of Rs.375 crores subscribed by WEPL in the first tranche cannot be disregarded or be said to exist only on paper.

29. Now we come to the second tranche of cost of acquisition of OCPS of Rs.310.60 crores. The facts show that, the assessee had initially granted loan in several tranches to WECL, majorly from September 2014 to March 2016. Later on, these loans were converted to OCPS at face value in November 2016. The AO however suspected foul play because the assessee had sold the entire OCPS in the month of March 2017 to related entity SSIPL, and this particular tranche was subscribed only in November 2016. This according to AO was undertaken with the sole intent to generate loss and reduce capital

gains tax liability. On the given facts before us, this suspicion of the AO is noted to be unfounded. The assessee is noted to have furnished evidence that the funds were primarily infused into WECL much prior i.e. between September 2014 and March 2016 and that in November 2016, it had only converted the loans into OCPS. Such act was shown to have been necessitated due to the petition, which had since been filed before the National Green Tribunal. Because of this litigation, it was expected that considerable time would be involved in ultimately getting environmental clearance for the thermal power projects. Hence, in absence of any foreseeable cash flows, which would enable WECL to clear the loans obtained from the assessee, a commercial decision was taken to convert the outstanding loans into OCPS. Further, the first tranche of Rs.375 crores was subscribed more than two year ago i.e. in October 2014. Having regard to surrounding circumstances and based on human probabilities, one cannot infer that the assessee would have known the outcome of the petition before the NGT which would adversely impact the valuation in the relevant FY 2016-17 and thus the assessee could have planned to purportedly generate overall loss by selling OCPS which were subscribed as far back in October 2014. According to us therefore, the overall cost of acquisition of Rs.686 crores, for capital gain computation purposes, is found to be tenable and includable in computing cost of acquisition deductible from the sale consideration, for arriving at capital gain/loss.

30. Now we come to the sale consideration component involved in this transaction. It is noted that, the AO had doubted the veracity,

particularly the valuation, of the sale consideration of Rs.300 crores agreed upon between the assessee and SIPPL. According to AO, when the assessee had already entered into a MOU with Adani to sell WECL for Rs.422 crores, then the sale consideration of Rs.300 crores agreed upon with SIPPL was inadequate. The AO was of the view that the transaction with SIPPL, a related entity was a controlled transaction and that the OCPS was sold at an undervalued figure to generate a loss. In this regard, we take note of the fact that, the AO had ignored the report obtained by the assessee from merchant banker, M/s Aether Consulting Pvt Ltd, which is found placed at Pages 108 to 130 of Paper-book, who had valued the OCPS based on risk and business profile as per the Net Asset Value ('NAV') Method. Although this valuation report is noted to have been placed by the assessee before the AO, but no defect or infirmity therein has been pointed out by the AO. According to us therefore, when the sale consideration agreed upon between related parties was supported by an independent valuation report obtained from an expert in this field, there was no reason to allege it to be under-valued, unless the Revenue points out any defect or error in the valuation methodology.

31. As far as the MOU with Adani is concerned, we note that the initial MOU involved sale of shares of WECL for Rs.422 crores, but the said MOU was ultimately never acted upon. The Ld. AR explained that, when the MOU was entered into in October 2014, the market fundamentals favoured the thermal energy business but by 2016, the business factors had become unfavourable. He showed us that, in

2014, the WECL held vital permissions from regulatory authorities to undertake coal based power projects, which made it an attractive investment for third parties like Adani. However, the National Green Tribunal, vide order dated 21st December 2016, copy of which is found at Pages 131 to 179 of the Paper Book, had set aside the environmental clearance granted to WECL to set-up coal based thermal plants, which indeed adversely impacted its valuation. The contemporaneous fact is also that, even Adani ultimately did not acquire WECL for Rs.422 crores. Rather, it was in April / May 2019 that, Adani acquired the three SPVs of WECL for an aggregate consideration of Rs.295 crores. Having regard to foregoing, we therefore find merit in the submissions of Ld. AR that, the sale consideration of Rs.300 crores agreed between the assessee and SIPPL cannot be said to be under-valued or on the lower side.

32. The Ld. AR has also explained the rationale behind the decision taken to sell the shares of WECL to SIPPL. It was shown that BK Goenka Group held majority stake i.e. 62% in the assessee. Apart from BK Goenka Group, Mr. V.K. Mittal held 38%. As already noted at Para 16 above, the WEPL was in EPC business and involved in thermal and renewable energy business through its subsidiaries, WECL and WREPL respectively. Since the macro fundamentals of this business was deteriorating, WEPL had decided to exit the same, for which it had sold the renewable energy business i.e. WREPL to Tata Power and the EPC business was demerged and taken over by V K Mittal Group, who were the minority stakeholder of WEPL. The

only business therefore, remaining in WEPL was thermal energy business being carried on through WECL, which the stakeholders at that time intended to continue but wanted to cash on the proceeds to enable the investors to deploy the funds as per their own requirements. Accordingly, WEPL decided to sell the interest in WECL to another SPV i.e. SIPPL which was created specifically to attain this objective, and WEPL was later on merged with Welspun Steel Ltd. For selling the OCPS of WECL, fair valuation of the thermal business was obtained from merchant banker and the investment in WECL was sold for Rs.300 crores, which as noted above was fair and cannot be said to be under-valued. Hence, having regard to the foregoing facts and circumstances, we agree with the assessee that there indeed was business rationale behind sale of shares of WECL which was undertaken at fair market value.

33. Moreover, as noted earlier, the assessee is entitled to arrange its affairs in the manner to make it tax efficient or mitigate its tax liability within the four corners of law. Indeed, the assessee had derived capital gains during the year. At the same time, the assessee held investment in shares which, having regard to their fair market value, were loss making. Accordingly, if the assessee decided to off-load such shares at its fair market value, even if, to its related entity, to mitigate the tax liability arising on capital gains, it cannot be said to be a tool for tax avoidance. There is no prohibition in law that an assessee cannot transact with related parties, but the burden is to demonstrate that the transaction is at arm’s length. Hence, what essentially boils down to is

whether the OCPS was sold at a fair value or whether the price was artificially arrived at to inflate the loss. In this respect, as noted by us above, the facts on record do not suggest that sale prices of OCPS was artificially deflated. Rather, it was supported by an independent report of merchant banker, and later on, the same investment was sold at a comparatively lower price to third party. We therefore do not find any infirmity in the sale consideration of OCPS as well.

34. The reliance placed by the Revenue on the decision of **CIT Vs Wipro Ltd (50 taxmann.com 421)** is found to be factually distinguishable. In the decided case, the assessee had earned short-term capital gains from sale of shares in one transaction. Thereafter, to avoid this capital gains tax liability, it had sold the shares of its subsidiary, WFL, which it had acquired at a premium of almost Rs.107 crores for a pittance rate of a paisa being Rs.75,000/- in aggregate to three ex-employees of the group. The sale consideration was found to be grossly under-valued for the reason that, the fundamentals of WFL did not justify this price and that assessee had acquired shares in WFL from a third party in the immediately preceding year for Rs.17.25 share as opposed to sale for one paisa per share. Also, immediately after divesting the stake for Rs.75,000/-, the assessee had again reinvested and acquired stake of Rs.95 crores in the same WFL which clearly showed that it never intended to divest and that the fair value of shares sold was also not Rs.75,000/- as claimed by the assessee. Having regard to these specific facts and circumstances, the Hon'ble Court had held that the sale of stake in WFL worth Rs.100 crores for

Rs.75,000/- was a sham arrangement intended to solely avoid tax. However, from the discussions made by us in the preceding paragraphs, it is evident that neither such facts are involved in the present case nor any such case has been made out by the AO. Hence, this decision is held not to aid the revenue.

35. The discussions made and decision taken by us revolved around the adverse views taken by the AO on this issue. We notice that there is one more angle to look at the issue on hand, i.e., If the transactions entered between various parties are analysed, we notice that following two different types of transactions would emerge:-

> (a) The first one is the investment made by WEPL in the OCPS issued by WECL. It consisted of Rs.375 crores (+) Rs.305.20 crores (+) Rs.5.40 crores aggregating to Rs.686 crores (rounded). This investment of Rs.686 crores have been sold for a consideration of Rs.300 crores. The issue before us is related to the loss claimed by the assessee in respect of these transactions. It is pertinent to note that the above said OCPS were sold by WEPL in March, 2017 falling in AY 2017-18.
>
> (b) The second one is the investment made by WECL in the OCPS issued by WERPL. It consisted of Rs.300 crores only. Since WERPL merged with WEPL, the above said investment made by WECL was required to be written off. The fact would remain that the loss arising on account of writing off of Rs.300 crores was not claimed as deduction by WECL nor was it carried forward. It is pertinent to note that the merger of WERPL with WEPL has taken place on the appointed date of

01-01-2015. Consequently, WECL has written of investments in the year relevant to AY 2015-16.

36. It can be noticed that both the above said transactions are independent transactions and they are nothing to do with each other, except for the fact that a part of amount of Rs.375 crores collected by WECL by issuing OCPS was invested to the extent of Rs.300 crores in the OCPS of WERPL. Thus,

(a) the OCPS issued by WECL to WEPL and

(b) the OCPS issued by WERPL to WECL

are two different transactions carrying different rights and liabilities. Hence they are not connected with each other. However, it appears that the AO has mixed up both the transactions. We notice that the AO has examined the transactions relating to issue and writing off of Rs.300 crores in AY 2017-18, even though those transactions are relevant for AY 2015-16. The AO has taken adverse view with respect to the same and accordingly, arrived at the conclusion that the investment made by WEPL in the OCPS issued by WECL is also sham, even though it is an independent transaction. However, we are of the view that the AO was not justified in doing so. Hence the disallowance of claim of both long term and short term capital loss was not correct on this reasoning also.

37. In view of the above facts and for the reasons set out above, we therefore hold that the AO was unjustified in disallowing the aggregate capital loss of Rs.423 crores by treating the transaction involving sale

of OCPS by WEPL to be a colorable device and accordingly uphold the order of Ld. CIT(A) deleting the impugned disallowance. This ground is therefore dismissed.

38. Ground Nos. 2 & 3 relates to the disallowance of Rs.9,69,98,557/- made by the AO u/s. 14A of the Act both while computing income under normal computational provisions as well as book profit computed u/s 115JB of the Act. Brief facts qua this issue are that, the assessee company had earned dividend income of Rs.55/- during the year and accordingly equivalent amount of Rs.55/- was disallowed *suo-moto* u/s 14A in the return of the income. The AO however rejected the same and invoked Rule 8D and thereby computed disallowance u/s 14A of Rs.9,69,98,612/-, being 1% of average value of investments. Aggrieved by the said disallowance, the assessee preferred appeal before the ld. CIT(A) who upheld the assessee's action of making disallowance u/s 14A of the Act to the extent of exempt income earned i.e. Rs.55/- and deleted the further disallowance computed by the AO u/s 14A read with Rule 8D. Aggrieved by the order of the ld. CIT(A), the Revenue is in appeal before us.

39. Heard both the parties. We note that the Ld. CIT(A) had rightly followed the decision of Hon'ble Bombay High Court in the case of **M/s. Nirved Traders Pvt. Ltd. Vs. DCIT (ITA. No.149 of 2017)** for holding that the disallowance u/s 14A of the Act is to be restricted to the extent of exempt income earned by assessee. It is noted that the Hon'ble Bombay High Court in the case of M/s. Nirved Traders Pvt.

Ltd. Vs. DCIT (supra) had framed the following question of law, which reads as under: -

> "Whether ITAT was right in law in confirming the disallowance under Section 14A of the Income Tax Act, 1961 in excess of exempt income earned by the Assessee during the assessment year in question?"

40. The Hon'ble jurisdictional High Court is noted to have taken note of the decisions of Hon'ble Delhi & Karnataka High Courts in the cases of **Cheminvest Ltd. Vs. CIT (378 ITR 33)** & **Pragati Krishna Gramin Bank Vs. JCIT (256 Taxman 349)**. The Hon'ble High Court also referred to their view taken earlier in the case of **PCIT Vs. HSBC Invest Direct (India) Ltd.** to answer the question in favour of assessee and hold that, the disallowance u/s 14A cannot exceed the exempt income so earned by the assessee during the year. The relevant findings of the Hon'ble High Court are as follows :-

> "5. Having heard the learned Counsel for the parties and having perused the documents on record, consistently different High Courts in the country have taken a view that the disallowance under Section 14A of the Act read with Rule 8D of the Rules cannot exceed the Assessee's exempt income. The Delhi High Court, in the case of Cheminvest Ltd. Vs. Commissioner of Income Tax 1, has held that when the Assessee has not earned any income which was exempt from tax, disallowance of the expenditure under Section 14A read with 8D of the Rules would not be permissible.

6. Karnataka High Court, in the case of Pragati Krishna Gramin Bank Vs. Joint Commissioner of Income-tax2, has held that expenditure in relation to income not includable in the total income cannot exceed such income. It was observed as under.

> "14. We make it clear that the expenditure for earning exempted income has to have a reasonable proportion to the income, so earned, going by the common financial prudence. Therefore, even if the Assessing Authority has to make an estimate of such an expenditure incurred to earn exempted income, it has to have a rational nexus with the amount of income earned itself. Disallowance under Section 14A of Rs.2,48,85,000/- as expenses to earn exempted Dividend income of Rs.1,80,30,965/- is per se absurd and 1 378 ITR 33 2 [2018] 256 Taxman 349 (Karnatama) URS 3 of 7 4 3-ITXA 149-17.odt hypothetical. The disallowance under Section 8D cannot exceed the expenses claimed by assessee under the Proviso to Rule 8D. Therefore, where the assessee claimed that assessee did not incur any such expenditure during the year in question to earn Dividends of Rs.1,80,30,965/-, the burden was upon the assessing authority to compute the interest on such borrowed funds which were dedicatedly used for investment in securities to earn such exempted Dividend income. The disallowance under Section 14A cannot be wild guesswork bereft of ground realities. It has to have a reasonable and close nexus with the factually incurred expenses. It is not deemed disallowance under Section 14A of the act but an enabling provision for assessing authority to compute the same on the given facts and figures in the regularly maintained Books of

Accounts. The assessing authority also could not have called upon the Assessee himself to undertake the exercise of computing the disallowance under Section 8D of the Rules. Such abdication of duty is not permissible in law. Since no such exercise has been undertaken by the assessing authority, the case calls for a remand."

7. Gujarat High Court, in the case of Commissioner of Income-tax-I Vs. Corrtech Energy (P.) Ltd.3, has held and observed as under :

"4. Counsel for the Revenue submitted that the Assessing Officer as well as CIT (Appeals) had applied formula of rule 8D of the Income Tax Rules, since this case arose after the assessment year 2009-2010. Since in the present case, we are concerned with the assessment year 2009-2010, such formula was correctly applied by the Revenue. We however, notice that sub-section (1) of section 14A provides that for the purpose of computing total income under chapter IV of 3 [2015] 372 ITR 97 URS 4 of 7 5 3-ITXA 149-17.odt the Act, 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. In the present case, the tribunal has recorded the finding of fact that the assessee did not make any claim for exemption of any income from payment of tax. It was on this basis that the tribunal held that disallowance under section 14A of the Act could not be made. In the process tribunal relied on the decision of Division Bench of Punjab and Haryana High Court in case

of CIT v Winsome Textile Industries Ltd. [2009] 319 ITR 204 in which also the Court had observed as under :

"7. We do not find any merit in this submission. The judgement of this court in Abhishek Industries Ltd. (2006) 286 ITR 1 was on the issue of allowability of interest paid on loans given to sister concerns, without interest. It was held that deduction for interest was permissible when loan was taken for business purpose and not for diverting the same to sister concern without having nexus with the business. The observations made therein have to be read in that context. In the present case, admittedly the assessee did not make any claim for exemption. In such a situation section 14A could have no application."

5. We do not find any question of law arising. Appeal is therefore dismissed."

8. Recently, this Court, in a decision dated 4th February, 2019, in the case of The Pr. Commissioner of Income Tax-10 Vs. HSBC Invest Direct (India) Ltd. had observed as under.

"4. Having heard learned Counsel for the parties and perused documents on record, we notice that in Cheminvest Ltd. (supra) Delhi High Court had referred to and relied upon its earlier decision in the case of CIT Vs. Holcim India (P) Ltd. (I.T.A. No.486 of 2014, decided on 5 th September 2014). we further notice that this Court in Income Tax Appeal No.693 of 2015 by an order dated 21 st November, 2017 while dismissing the Revenue's appeal on similar issue had noted that the decision of Delhi High Court in case of Holcim India (P) Ltd. (supra) had adopted

> the same principles. In the present case, Counsel for the Revenue however, points out that this is not a case where the assessee had earned no income which was exempt from tax. However, in our opinion, the ratio of the above noted decisions in the cases of Cheminvest Ltd. and Holcim India (P) Ltd. (supra) would include a facet where the assessee's income exempt from tax is not NIL but has earned exempt income which is larger than the expenditure incurred by the assessee in order to earn such income. In such a situation that disallowance cannot exceed the exempt income so earned by the assessee during the year under consideration. We do not find any error in the view of the Tribunal. We record that the assessee had offered voluntary disallowance of expenditure of Rs.1.30 crores, which is not been disturbed by the Tribunal.
>
> 5. The tax appeal is dismissed."

9. In view of such consistent trend of the High Courts, we answer the question in favour of the Assessee. We reverse the decision of the Tribunal to the extent of limiting the disallowance under Section 14A of the Act to a sum of Rs.1,13,72,545/-."

41. It is also noted that this particular issue stands covered in favour of the assessee by the decision rendered by coordinate Bench of this Tribunal in assessee's own case for the earlier AYs 2013-14 & 2014-15 in ITA Nos.6759/Mum/2017 & 223/Mum/2018. In these decisions, the coordinate Bench has held that the disallowance u/s 14A cannot

exceed the exempt income, and thus directed the AO to restrict the quantum of disallowance accordingly.

42. The Ld. CIT(A) is also noted to have taken note of the Explanation which has been inserted in the Finance Act, 2022 under Section 14A of the Act. The said Explanation clarifies that, the provisions of section 14A shall apply and be deemed to have always applied in a case where exempt income has not accrued or arisen or has not been received during the previous year. The Ld. CIT(A) rightly observed that, the aforesaid amendment is explicitly clear that it shall be effective from 01.04.2022 and therefore has to be applied prospectively and not retrospectively. Gainful reference in this regard is made to the decision of Hon'ble Delhi High Court in the case of **PCIT v. Era Infrastructure (India) Ltd. (ITA No. 204/2022)**, following which the coordinate Bench of this Tribunal in the case of **Asstt. CIT v. Bajaj Capital Ventures (P.) Ltd. (196 ITD 24)** has held that the amendment to Section 14A introduced by the Finance Act 2022 shall apply from Assessment Year 2022-23.

43. Before us, the Ld. DR was unable to bring on record any contrary judicial precedent or any change in position of law to controvert the above findings of the Ld. CIT(A). In view of the above and following the binding decisions of jurisdictional High Court (supra), we see no reason to interfere with the above findings of the Ld. CIT(A) restricting the disallowance u/s 14A to the extent of exempt income i.e. Rs.55/- as suo moto offered by the assessee.

44. Now we come to the addition made on account of Section 14A read with Rule 8D, while computing book profit u/s 115JB. We find that this Tribunal in assessee's own case for earlier AYs 2013-14 & 2014-15 (supra), following the decision of the Special Bench in the case of **ACIT Vs Vireet Investments Pvt Ltd (82 taxmann.com 415)**, has held that Rule 8D cannot be invoked and applied, while computing book profit under clause (f) of Explanation (1) to Section 115JB. Following the same and having regard to our above findings restricting the amount disallowable u/s 14A to the extent of exempt income i.e. Rs.55/-, we uphold the order of Ld. CIT(A) deleting the further addition u/s 14A r.w. Rule 8D made by the AO while computing book profit under clause (f) of Explanation (1) to Section 115JB of the Act. Accordingly, these grounds of appeal stand dismissed.

45. In the result, the appeal of the revenue stands dismissed.

Order pronounced in the open court on this 29/02/2024.

Sd/-	Sd/-
(BR BASKARAN)	**(ABY T. VARKEY)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

मुंबई Mumbai; दिनांक Dated : 29/02/2024.
Vijay Pal Singh, (Sr. PS)

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त / CIT
4. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
5. गार्ड फाईल / Guard file.
6.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

उप/सहायक पंजीकार /(Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**