IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH : BANGALORE

BEFORE SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER
AND
SHRI PRAKASH CHAND YADAV, JUDICIAL MEMBER

ITA No.890/Bang/2024
Assessment year : 2017-18

Shiv Nadar and Sanjay Kalra Associates LLP, 9, Shendge Avenue, 2nd Floor, 2nd Street Kamraj Road, Bangalore – 560 042. **PAN : ACTFS 2053G**	Vs.	The Asstt. Commissioner of Income Tax, Circle 1(2)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Ravishankar S., Advocate
Respondent by	:	Shri V. Parithivel, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	11.07.2024
Date of Pronouncement	:	30.07.2024

O R D E R

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the order dated 12.03.2024 of the CIT(Appeals), National Faceless Appeal Centre, Delhi [NFAC], for the AY 2017-18 on the following grounds:-

> " 1. That on the facts and circumstances of the case and in law, the National Faceless Appeals Centre [the CIT(A)] erred in dismissing the appeal of the appellant against the order dated 22.11.2019, passed under section 143(3) of the Income Tax Act,

1961 (the Act), without affording adequate opportunity of being heard, in gross violation of principles of natural justice.

2. That on the facts and circumstances of the case and in law, the CIT(A) erred in not appreciating that the assessment having been framed in the name of a non-existent LLP was illegal, bad in law and deserved to be quashed.

Without Prejudice

3. That on the facts and circumstances of the case and in law, the CIT(A) erred in confirming the disallowance of Rs. 1,26,31,525/- being expenditure incurred towards professional charges paid to M/s. Graymatter Solutions LLC, USA, by treating the same as capital expenditure.

3.1 That the CIT(A) erred in holding that the professional charges paid for consultancy services provided by M/s Graymatter Solutions LLC, USA was towards acquisition of capital asset and hence capital in nature.

3.2 That the CIT(A) erred in not appreciating that the appellant was engaged in the business of acquiring stakes/ownership of entities and thereby the professional charges paid for facilitating business operations was wholly and exclusively for the purpose of business and hence allowable as deduction under section 37(1) of the Act.

3.3 That the CIT(A) erred in holding that the business of the appellant had not commenced in the relevant assessment year 2017-18 and as a consequence, conditions of section 37(1) of the Act remained unsatisfied.

3.4 Without prejudice, that the CIT(A) erred on facts and in law in not allowing depreciation on professional charges held to be capital in nature.

4. That on the facts and circumstances of the case and in law, the CIT(A) erred in confirming disallowance of Rs.83,54,360/- under section 14A of the Act, by holding the same to be expenditure incurred for earning exempt income.

4.1 That the CIT(A) failed to appreciate that in the absence of any exempt income earned in the relevant assessment year, the provisions of section 14A of the Act had no application at the very threshold.

4.2 Without prejudice, that the CIT(A) erred in upholding the action of the assessing officer in invoking Rule 8D of the Income Tax Rules, 1962 (the Rules') and disallowing Rs.83,54,360/- without appreciating that preconditions for applying the said rule as prescribed in sub-section (2) of section 14A of the Act were not satisfied.

4.3 Without prejudice, that the CIT(A) erred in upholding the action of the assessing officer erred in incorrectly applying provisions of Rule 8D of the Rules for the purpose of computation of disallowance and also in incorrectly computing disallowance under that rule.

5. That the CIT(A) erred in confirming the levy of interest under section 234A, section 234B and section 234C of the Act.

The appellant craves leave to add, alter, amend or vary from the aforesaid grounds of appeal at or before the time of hearing."

2. The assessee has also filed additional grounds vide letter dated 08.07.2024 which is as under:-

"1. The learned CIT(A) failed to appreciate that the order of assessment was passed on an entity, which was non-existent and the order ought to have been set aside as bad in law, on the facts and circumstances of the case.

2. The learned CIT(A) was not justified in passing the order on an entity, which was non existent and the order suffers from an incurable defect and is required to be set aside as bad in law and on facts, on the facts and circumstances of the case.

3. The learned Assessing Officer is not justified in law in charging the interest under section 234A, 234B and 234C of the Act and further the calculation of interest under section 234A, 234B and 234C of the Act is not in accordance with law since the

rate, method of calculation, quantum is not discernable from the order of assessment on the facts and circumstance of the case.

4. The Appellant craves leave to add, alter, amend, substitute, change and delete any of the grounds of appeal.

5. For the above and other grounds that may be urged at the time of hearing of the appeal, the Appellant prays that the appeal may be allowed and justice rendered."

3. We note from the above additional grounds the assessee has raised legal issue challenging the validity of the assessment and therefore, following the Hon'ble Supreme Court judgment in the case of M/s National Thermal Power Co. Ltd. Vs. CIT, 229 ITR 383 (SC), the additional grounds are admitted for adjudication.

4. Briefly stated the facts of the case are that the assessee is a Limited Liability Partnership (LLP) firm formed with the purpose of acquisition of stakes, ownership interests/rights in securities of entities mainly in the business of technology products & solutions. It filed return of income on 30.08.2017 declaring total income of Rs.2,52,16,460. The return was processed & later it was selected for scrutiny and statutory notices issued to the assessee. In response the assessee filed reply. It was seen from the details furnished by the assessee that it had made payments to Graymatter Solutions LLC, USA for the purposes of acquisition vide agreement dated 06.09.2015, The assessee produced Form 15CA certificates for making foreign remittance in favour of Graymatter Solutions LLC, USA. During the impugned year total payments of Rs.1,26,31,525 was remitted in 13 instances as professional charges for stated purpose of providing

professional consultancy services in the area of identifying healthcare technology companies with favourable fundamentals, growth potential, strategic values, etc. leading to acquisition of health care technology companies by the assessee. From the financial statements as on 31.03.2017, it was noticed that no such company had been acquired during the FY 2016-17 and it was further seen that the Master Service Agreement entered into with Graymatter Solutions LLC, USA had been cancelled by means of termination agreement dated 16.5.2017. Thus foreign remittances towards professional charges had not resulted in any acquisition of healthcare technology company and subsequent income therefrom and assessee was requested to show cause why the disallowance should not be made. The assessee furnished reply and relied on CIT v. Kalyanji Mavji & Co. 122 ITR 49, Eastern Investments Ltd. v. CIT, 20 ITR 1, Radhasoami Satsang v. CIT [1992] 193 ITR 321 submitted that same accounting principles were followed in the previous year and were allowed in 143(3) assessment order. The AO has incorporated the same in para 4.5 of his order and relying on submission of the assessee was examined by the AO and not accepted and he observed that the case laws relied by the assessee were distinguishable and not applicable to the facts of assessee's case. The AO noted that assessee has not earned or reported business income and the business of the assessee is only at the stage of acquisition of investments viz., medical healthcare companies from which income would arise in future and further noted that acquisition of medical healthcare companies can be categorised as investments in capital

asset, a revenue yielding apparatus, from which income will be derived. Therefore the expenses incurred towards acquisition of such capital asset is in the capital field and it cannot be treated as revenue expenditure. Accordingy expenditure incurred by way of foreign remittances towards professional charges to Graymatter Solutions LLC, USA for the purpose of acquisition of medical healthcare companies was categorized as capital expenditure and added back to total income of assessee and disallowed u/s. 37 of the Act. The AO further noted in his order that these expenses were allowed in the earlier assessment year without questioning the nature of income and expenses. In this year the nature of expenses has been verified and found the same not to be allowable. He further mentioned at para 4.11(ii) in the AY 2016-17 the issue of foreign remittances was not there and therefore there was no occasion to verify the same during the assessment proceedings and from the financials for AY 2016-17 in the return of income there is no such expenditure towards professional fees. Hence it is noted that the submission of the assessee is not correct that the same expenditure have been examined in the previous AY.

5. Further the AO noted that in the financial statement there is investment in equities and mutual funds to the tune of Rs.21,63,68,840 and loan funds (unsecured loans from others) to the tune of Rs.30 crores. The assessee was asked to furnish details of expenses incurred towards earning from investments and why section 14A should not be applied. In this regard the assessee furnished reply that there is no

exempt income earned during the year, therefore no disallowance could be made u/s. 14A and relied on various High Court judgments.

6. The AO from the submissions, he calculated disallowance u/s. 14A of Rs.83,54,360 and the same was disallowed and added back to the total income of the assessee. Aggrieved from the above order, the assessee filed appeal before the CIT(Appeals).

7. The CIT(Appeals) after considering written submissions and relying on various case laws upheld the order of the AO. Aggrieved, the assessee is in appeal before the ITAT.

8. The ld. AR reiterated the submissions made before the lower authorities and submitted that professional charges paid to Graymatter Solutions LLC, USA was as per Master Service Agreement dated 06.09.2015 for the purpose of providing professional consultancy services in the area of identifying healthcare technology companies, but the transactions were not materialised and the agreement was cancelled by both the parties as per termination agreement dated 16.05.2017. The AO has wrongly noted in his assessment order that the same issue was not in the previous year i.e. AY 2016-17 and he referred to financial statements placed at PB page 23, under direct expenses professional charges of Rs.1,34,16,232 were paid to Graymatter Solutions LLC, USA. He also pointed out that the nature of expenses were verified and it was allowed and in the impugned AY the assessee has also paid the sum net of expenditure as was paid in the previous AY. Accordingly he submitted that the principle of

consistency should be applied. He also relied on the jurisdictional High Court judgment in the case of CIT v. Onmobile Global Ltd. (2021) 129 taxmann.com 254 (Kar) and submitted that expenditure incurred by the assessee for acquiring/extending new business should be treated as revenue expenditure.

9. The ld. AR also argued on the legal issue in the additional grounds of appeal challenging the validity of the order passed in the name of non-existing entity and referred to paperbook in this regard.

10. The ld. AR further submitted that the AO has wrongly disallowed a sum of Rs.83,54,360 u/s. 14A whereas there was no exempt income received by the assessee. He further contended that the action of the AO in treating the income as exempt income that too notional, which was never earned/accrued since incorporation of LLC and during the AY 2017-18 the appellant had offered taxable income of Rs.9.33 crores on such investments, hence the question of exempt income does not arise. The company had not invested in securities which was tax free, but invested only in debt oriented mutual funds (without dividend) model and always offered tax on gain on such securities. Therefore, both the revenue authorities are not justified in making disallowance u/s. 14A. In support of his arguments he relied on various judgments relied before the ld. CIT(Appeals).

11. The ld. AR has filed compilation of case laws containing pages 1 to 68 which is placed on record.

12. The ld. DR relied on the order of the lower authorities and submitted that assessee incurred expenses towards acquisition/ establishment of medical healthcare companies cannot be considered as revenue expenditure, being capital in nature. The business of assessee had not commenced and hence the conditions laid down as per section 37(1) of the Act are not satisfied. He further submitted that the agreement made by the assessee was terminated on 16.5.2017 and the assessee has not declared any business income, therefore, it should not be treated as revenue expenditure.

13. The ld. DR further submitted that assessee has earned lot of exempt income which form part of total income and he further submitted that Board has issued Circular in this regard. He further submitted that investments cannot be managed without inherent expenses since no investments can be made without market analysis and expertise and the appellant has no such market expertise and necessary staff for investments in tax free income and therefore the assessee has to incur necessarily expenditure. It is not possible to invest and manage such huge investments without the expertise for selection of security and timely swaps necessitating cost for managing and supervising all the securities i.e., conveyance, travel, telephone, mobile bills, stationery, etc. He also relied on the Apex Court decision in the case of Maxopp Investments Ltd. v. CIT in Civil Appeal No.104-109/2015. As per Board Circular No.5 of 2014 even if the assessee has no exempt income, expenses are liable to be disallowed in

relation to investment which have potential to earn exempt income. He also referred to judgments relied by the CIT(Appeals).

14. Considering the rival submissions we noted that assessee has raised two issues on merits of the case. The first is disallowance made by the AO of Rs.1,26,31,525 treating the same as capital expenditure, whereas assessee has claimed it as revenue expenditure towards professional charges paid for identifying medical healthcare technology companies with feasible investments, growth potential, strategic value, etc. for the purpose of acquisition by the assessee. In this regard, the Master Service Agreement (MSA) was made with Graymatter Solutions LLC, USA dated 06.09.2015. The assessee had also obtained certificate from CA in Form 15CA for remittance of money for payment of professional charges as per MSA. The second issue is that AO made addition u/s. 14A of Rs.83,54,360. Considering the facts noted above, the amount paid to Graymatter Solutions LLC, USA towards professional charges for acquisition of new business in the area of healthcare technology companies and later on the purpose was not materialised. We also note from the order of AO that such expenses were not incurred in the previous year is not correct. In the financial statements produced before us for the AY 2016-17 the assessee has paid professional charges of Rs.1,34,16,232 and it was placed before the AO too and no disallowance was made in the 143(3) assessment. There is no dispute regarding genuineness of transactions for services rendered. The issue has been settled by the Hon'ble

jurisdictional High Court in the case of CIT v. Onmobile Global Ltd. (supra) in para 12 which is as under:-

> ***12.*** *The assessee has claimed an amount of Rs. 6,68,98,726/- as expenditure incurred as legal and professional charges in its profit and loss account. Out of the aforesaid amount, the Assessing Officer has disallowed an amount of Rs. 2,20,40,131/- that is the amount incurred on account of legal and professional charges incurred in connection with acquisition of the Company in France and legal and professional charges to file patent application for a sum of Rs. 24,08,000/-. The Assessing Officer has held the same to be in the nature of capital expenditure. The Tribunal, by following the decision of its co-ordinate Benches, has held that expenditure incurred by the assessee for conducting due diligence in report of a company which was to be acquired by the assessee is revenue in nature and has treated the same to be deductible expenditure under section 37(1) of the Act. The aforesaid finding of the Tribunal is based on meticulous appreciation of material on record and does not call for any interference. In the result, the fourth substantial question of law is also answered against the revenue and in favour of the assessee.*

15. The issue before us is also similar, therefore, respectfully following the above judgment, we hold that the payments made by the assesse are to be treated as revenue expenditure. Accordingly we allow the ground No. 2 & 3 raised by the on this issue.

16. Further in respect of disallowance u/s. 14A of Rs.83,54,360, we noted that during the impugned assessment year from the financial statements , computation of income and schedule of Exempt Income in the ITR Form the assessee has not earned any exempt income on its investments. As per the financial statements the assessee has earned short term capital gain on mutual funds of Rs.9,92,89,092 which is evident from the Profit & Loss account placed at page 52 of PB and details are available at paper book page No. 4 & 5 . The short term

capital gain reported in financial statements have not been disputed by the lower authorities. We also note from the financial statements that assessee has loan of Rs.30 crores from HCL Corporation P. Ltd. And in the previous financial year it was Rs. 80.00 crore. We found substance on the submission of the ld. AR that no disallowance u/s 14A of the Income Tax Act can be made if the assesse has not received any exempt income. However the AO has made disallowance under Rule 8D which is 1% of monthly average investments. Before the CIT(Appeals) as well as before us the ld. AR relied on the various judgments. Recently the coordinate Bench of Tribunal has decided similar issue in ITA No.892/Bang/2024 for AY 2014-15 in the case of Subramanya Constructions & Development Co. Ltd. by relying on the judgment of jurisdictional High Court in the case of PCIT v. Delhi International Airport P. ltd. [2022] 138 taxmann.com 112 (Kar) dated 25.05.2021 in which it has been held as under:-

> " 7. Considering the rival submissions, we note that during the impugned year, the AO has calculated disallowance u/s. 14A r.w. Rule 8D(2)(ii) & (iii) of Rs.2,83,83,345. Considering the entire facts of the case, we note from financial statements that the assessee has not received any exempt income during the year and therefore no disallowance could be made. This view is supported by the judgment of jurisdictional High Court in the case of PCIT v. Delhi International Airport P. Ltd. [2022] 138 taxmann.com 112 (Kar) dated 25.05.2021 in which it is held as under:-
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> " 6. The order dated 15-2-2021 passed in ITA No.133/2015, in paragraphs 11 to 14 reads as under;
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> "11. We have considered the submissions made on both sides and have perused the record. Substantial questions of law Nos. 1 and 3 are interlinked, therefore, we proceed to deal with the same together. Before proceeding further it is apposite to take note of the relevant

statutory provisions which are reproduced below for the facility of reference :

"Section 14A: 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.".

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act.

(3) The provisions of sub-section (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act.

…….

14. Now we may advert to the second substantial question of law. It is pertinent to note that for Assessment Year 2009-10 the assessee has not earned dividend income. The aforesaid fact has not been disputed by the revenue. It is also relevant to mention that Circular No. 5/2014 dated 11-2-2014 is not applicable in the instant case as the instant case pertains to Assessment Year 2009-10. The aforesaid Circular has no retrospective operation. It is noteworthy that aforesaid Circular was not even relied by the parties. This court in Commissioner of Income Tax v. Kingfisher Investment India Ltd. vide judgment dated 29-9-2020 inter alia held that disallowance under section 14A read with rule 8D has to be made even when taxpayer in a particular year has not earned any exempt income. This court relied on the decision of the Supreme Court in Maxopp Investment Ltd. (supra) which was reproduced in Paragraph 5 of the decision and reliance was also placed on Circular dated 11-2-2014 issued by Central Board of Direct Taxes (CBDT). However, the aforesaid decision was subsequently considered by this court in judgment dated 16-1-2021 passed in I.T.A.No.271/2017 (Principal Commissioner of Income Tax v. Novel Software Development) in which it was held that decision of this court in Kingfisher Finvest Ltd. was distinguishable as the basis of the aforesaid decision of this court was the decision of the Supreme Court

in Maxopp Investments Ltd. supra and it was held that the aforesaid decision does not deal with applicability of section 14A of the Act. However, eventually this court agreed with the view taken by High Court of Madras in CIT v. Chettinad Logistics (P.) Ltd., (2017) 80 taxmann.com 221 (Mad.) and Kem Invest Ltd. v. CIT, (2015) 16 taxmann.com 118 (Delhi) and held that since no exempt income has accrued to the assessee therefore, the provisions of section 14A of the Act do not apply to the fact situation of the case. Therefore, it has become necessary for us to clarify the view taken in the two decisions viz., Kingfisher Finvest India Ltd. and Novel Software India (P) Ltd. supra. At this stage, we may refer to Paragraph 40 of the decision of the Supreme Court in Maxopp supra, the relevant extract of which reads as under:

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 the 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 that 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 upon 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.

15. From perusal of the relevant extract of the Supreme Court, it is evident that the decision in Maxopp Investment Ltd. supra deals with applicability of Section 14A of the Act. Therefore, the observations made with regard to applicability of section 14A in M/S. Novel Software India (P.) Ltd. are factually incorrect and we hasten to clarify the same. However, from relevant extract of Paragraph 40, it is evident that only expenses proportionate to earning of exempt income could be disallowed under section 14A of the Act and the decision of Maxopp Investment Ltd. is an authority for the aforesaid proposition that the

provision is relatable to earning of actual income. The object of section 14A 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 of the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The High Court of Madras has relied on the decision of the Supreme Court in Commissioner of Income Tax v. Walfort Share and Stock Brokers (2010) 326 ITR 1 wherein it has been held that Section 14A is relatable to income of actual income or not notional or anticipated income. Therefore, the conclusion arrived at by us in Novel Software India (P.) Ltd. is affirmed but for different reasons. It is also clarified by us that while recording the conclusion in Kingfisher Finvest Ltd. that disallowance under section 14A has to be made even taxpayer has not earned any exempt income, this court has misread the ratio of the decision of the Supreme Court in Maxopp Investment Ltd. supra and therefore, the aforesaid view being contrary to the law laid down by the Supreme Court is not a binding precedent.

In view of preceding analysis, the second substantial question of law is also answered against the revenue and in favour of the assessee. In the result, we don to find any merit in this appeal, the same fails and is hereby dismissed.'

7. In light of the aforesaid judgment passed in ITA No. 133/2015, the question of law is answered in favour of the assessee and against the revenue. Resultantly, the appeal stands dismissed. ”

8. Against the above judgment, the revenue preferred SLP before the Hon’ble Apex Court and Hon’ble Apex Court has issued notice, reported in [2022] 138 taxmann.com 113 (SC) & in another case reported [2022] 142 taxmann.com 328 (SC). Since both the parties could not bring the status of the case before the Hon’ble Apex Court, therefore, respectfully following the judgement of the jurisdictional High Court PCIT v. Delhi International Airport P. Ltd. noted supra we allow the appeal of the assessee.”

17. Respectfully following the above judgment, we allow this ground of appeal in above terms. The findings recorded by both the authorities below and submissions made by the ld. DR has no relevance regarding disallowance of administrative expenses, since the

similar issue has been settled by the jurisdictional High Court in favour of the assessee.

18. Levy of interest u/s. 234A, 234B & 234C is consequential in nature.

19. Since we have allowed the appeal of the assessee on merits, the legal issue raised by the assessee challenging the validity of assessment order is left open.

20. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 30th day of July, 2024.

Sd/-	Sd/-
(PRAKASH CHAND YADAV)	(LAXMI PRASAD SAHU)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Bangalore,
Dated, the 30th July, 2024.
/*Desai S Murthy /*

Copy to:
1. Appellant 2. Respondent 3. Pr.CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.