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

Judgment reserved on: 25.11.2011
% Judgment delivered on: 12.12.2011

\+ ITA 1367/2008, 1368/2008 & ITA No.1391/2008

COMMISSIONER OF INCOME TAX …APPELLANT

VS.

WIMCO SEEDLINGS LTD. …RESPONDENT

Advocates who appeared in this case:
For the Appellant : Mr. Sanjeev Rajpal
For the Respondents: Ms. Kavita Jha and Mr. Somnath Shukla

CORAM :-
HON'BLE MR JUSTICE SANJAY KISHAN KAUL
HON'BLE MR JUSTICE RAJIV SHAKDHER

RAJIV SHAKDHER, J

1. The captioned appeals being three (3) in number are directed against a common judgment of the Income Tax Appellate Tribunal (hereinafter referred to as the Tribunal) dated 22.02.2008. ITA No.1367/2008 relates to Assessment Year 1991-1992; ITA No.1368/2008 pertains to Assessment Year 1990-1991, while ITA No.1391/2008 pertains to Assessment Year 1989-1990.

1.1 The short issue involved in these appeals is: whether common expenses incurred by an assessee can be allocated towards taxable and non-taxable income

under the provisions of Section 14A of the Income Tax Act, 1961 (hereinafter referred to as the 'I.T. Act') as it stood at the relevant point in time.

2. It is important to note that this court has passed orders from time to time in ITA No.1367/2008, which has been virtually treated as the lead case. On perusal of the order-sheets pertaining to ITA No.1367/2008, it is found that on the very first date when the said appeal was moved i.e., 03.12.2008, it was pointed out to the Revenue that since the impugned judgment of the Tribunal was based on its own decision, rendered on the same issue, for Assessment Year 1994-1995; which was in favour of the assessee – whether the Revenue had preferred an appeal against the said decision. Since then, several adjournments for the past three years have been taken on this ground alone.

3. In the interregnum, it was also pointed out, both by the counsel for revenue as well as the assessee, that an identical issue was pending consideration before a coordinate bench of this court. This aspect is noted in order dated 26.04.2011. The coordinate bench comprising of Hon'ble Mr. Justice Badar Durrez Ahmed and Hon'ble Mr. Justice Siddharth Mridul have delivered a common judgment dated 18.11.2011; in respect of a batch of appeals; the lead appeal being: ITA No.687/2009 titled Maxopp Investment Ltd. Vs. Commissioner of Income Tax, New Delhi.

4. In the background of the aforementioned orders, we were informed as recently as on 21.11.2011 by the learned counsel for the revenue once again that he had to obtain instructions as to whether the revenue had challenged the Tribunal's decision rendered in the case of the assessee, for the Assessment Year 1994-1995. Consequently, the matter was adjourned to 25.11.2011. On

25.11.2011, the learned counsel for the revenue could do no better than produce a letter dated 21.11.2011 received from the concerned Income Tax Officer which, seems to suggest that the revenue till that date had not been able to obtain a certified copy of the judgment of the Tribunal passed in respect of Assessment Year 1994-1995.

5. What amazes us is that the revenue did not deem it fit to file an appeal (if it otherwise was of the view that the judgment of the Tribunal raised substantial questions of law which deserved the attention of this court) by taking recourse to an application, seeking exemption from filing the certified copy of the judgment.

6. In view of the aforesaid, it is quite clear if we were to apply the principle of consistency what holds good qua the assessee for assessment year 1994-1995 should also hold good for the assessment years under consideration.

7. It is important to note that in respect of the three (3) appeals filed: in so far as ITA Nos.1367/2008 and 1368/2008 are concerned, the revenue has averred that the tax effect in each appeal is Rs.12,67,867/-; while in ITA No.1391/2008, the tax effect is "nil" "as income is assessed under section 115 J" of the Income Tax Act, 1961 (in short, the IT Act).

8. Having regard to the aforesaid facts, one option available to us is to dismiss these appeals. The other option available is that, the matter be remanded to the Assessing Officer having regard to the observations made by the coordinate bench in the case of ***Maxopp Investment Ltd.*** (*supra*). In this regard, however, it is important to note that the bench of the Tribunal which initially heard the matter qua the assessee in respect of assessment year 1994-95 comprised of a Judicial Member and an Accountant Member; who rendered separate and divergent

opinions. Consequently, the matter was referred to a third Member i.e., the Vice President of the Tribunal. The Vice President of the Tribunal agreed with the Judicial Member, which resulted in the appeal of the assessee for assessment years 1994-1995 being allowed.

8.1 In the impugned judgment, the Tribunal has extracted the relevant portion of the opinion rendered by the third member. A perusal of the view expressed by the third member, in sum and substance suggests that he was of the opinion that section 14 A of the IT Act was brought on to the statute with the view to correct the lacuna found in the I.T. Act, which had been noticed in the decisions rendered by the Supreme Court, whereby expenses incurred in relation to an indivisible business comprising of activities which generated both taxable and tax free income, were sought to be bifurcated artificially so as to disallow expenditure, which was, purportedly incurred to earn tax free income. The third member was of the view that the introduction of section 14 A in the IT Act by virtue of Finance Act, 2001; (which was incidentally given effect to retrospectively, i.e., from 01.04.1962) did not confer on the Assessing Officer the authority to deem or assume certain expenditure to have been incurred in relation to tax free income. The relevant observations of the third member as extracted in the impugned judgment read as follows :-

> "….In my view, the order of the learned JM is to be preferred. On the construction of section 14A, I am inclined to agree with the learned JM that only expenditure which has been proved to have been incurred in relation to the earning of tax free income, can be disallowed and the section cannot be extended to disallow even expenditure which is

assumed to have been incurred for the purpose of earning the tax free income. The word 'incurred' refers to the factual spending of the expenditure in relation to the exempt income and does not refer to a deemed spending or assumed spending for the purpose. The learned AM has referred to the Memorandum explaining the Finance Bill, 2001. His conclusion is that the section has been introduced to nullify certain decisions of the Supreme Court (cited supra). The proposition laid down in those decisions is that where there is both activity which brings in taxable income and activity which brings in tax free income and both activities constitute an indivisible income, then the expenditure incurred by the assessee for the purposes of the indivisible business cannot be artificially broken up to identify and disallow expenditure which is supposed to have been incurred for the purpose of earning the exempted income. It was this proposition that is sought to be nullified by section 14A as rightly held by the learned AM. However, while applying the section there is no authority conferred by the section upon the Assessing Officer to deem or assume certain expenditure to have been incurred in relation to the tax free income. Common expenditure incurred at the head office cannot be broken up artificially to attribute or apportion a part thereof to the earning of the tax free income on the assumption that such part of the common expenditure was incurred in relation to the tax free income. Not only the incurring of the expenditure but also its relationship to the exempted income must be clear and must be capable of being ascertained on the face of assessing officer to not only show that

some expenditure was factually incurred but also to show its relationship with the income exempt from tax. The section may have nullified the judgment of the Supreme Court cited above but only to the extent that even in an indivisible business consisting partly of taxable activities and partly of tax free activities, it is open to the Assessing Officer to identify expenditure if any, incurred in relation to the earning or non-taxable income and disallow the same. But the section cannot be taken beyond that and every item of expenditure which has no apparent connection or nexus with the earning of the tax free income cannot be in part be attributed on some yardstick, whatever may be the sanctity behind such yardstick, to the earning of the tax free income. For such assumption or deeming, there is no authority given in the section as it stood for the year under appeal…."

8.2 These observations of the Tribunal for the assessment year 1994-1995, are in our opinion, contrary to some of the observations made by a coordinate bench in Maxopp Investment Ltd. (supra). A particular reference in this regard is made to the expression '***incurred***' and '***in relation to***' which finds reference in provisions of section 14A as it stood with its insertion in I.T. Act for the first time in 2001; albeit with retrospective effect. Section 14 A as introduced by Finance Act, 2001 read as follows :-

"Expenditure incurred in relation to income not includible in total income .

14A. 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."

8.3 As would be apparent by virtue of subsequent amendments, no change has been brought about in the aforementioned provision. The subsequent amendments were brought about by Finance Act, 2002 and Finance Act, 2006. The change brought about by subsequent amendments, have essentially, resulted in the provision as it stood originally being numbered as sub section (1); the proviso which was inserted by virtue of Finance Act, 2002 has been appended at the end of the section, while the amendment brought about by Finance Act, 2006 which, resulted in insertion of two sub sections i.e., sub-section(2) and sub-section(3), have been inserted immediately after sub-section(1). The amended section 14A as it stood pursuant to amendment brought about by Finance Act, 2002 and, thereafter by Finance Act, 2006 reads as follows:-

<u>Finance Act, 2002</u>

"Expenditure incurred in relation to income not includible in total income.

14A. For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."

Finance Act, 2006

"Expenditure incurred in relation to income not includible in total income

14A. (1) 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.

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year beginning on or before the 1st day of April, 2001."

8.4 With effect from 24.03.2008, the Central Board of Direct Taxes (in short 'CBDT') has also framed a rule as per the mandate of the provision which is numbered as Rule 8D.

9. Given these amendments, the coordinate bench adverted to submissions with regard to the term '***incurred***' and the expression '***in relation to***' as obtaining in section 14 A as originally inserted in the IT Act, which as is evident from the above, was converted into sub-section(1). Therefore, the observations of the bench in respect of the said expression attain criticality and cannot be wished away. For the sake of convenience the observations made in paragraphs 24 to 28 of the judgment are extracted hereinafter. The said observations to our minds, would be relevant in arriving at a correct conclusion in this case as well.

"24. ***….We do not agree with the submission of the learned counsel appearing on behalf of the assessees that a narrow meaning ought to be ascribed to the expression "in relation to" appearing in section 14A of the said act. The context does not suggest that a narrow***

meaning ought to be given to the said expression. It is pertinent to note that the provision was inserted by virtue of the Finance Act, 2001 with retrospective effect from 01/04/1962. In other words, it was the intention of Parliament that it should appear in the statute book, from its inception, that expenditure incurred in connection with income which does not form part of total income ought not to be allowed as a deduction. The factum of making the said provision retrospective makes it clear that Parliament wanted that it should be understood by all that from the very beginning, such expenditure was not allowable as a deduction. Of course, by introducing the proviso it made it clear that there was no intention to reopen finalised assessments prior to the assessment year beginning on 01/04/2001. Furthermore, as observed by the Supreme Court in Walfort (supra), the basic principle of taxation is to tax the net income, i.e., gross income minus the expenditure and on the same analogy the exemption is also in respect of net income. In other words, where the gross income would not form part of total income, it's associated or related expenditure would also not be permitted to be debited against other taxable income.

25. We are of the view that the expression "in relation to" appearing in Section 14 A of the said act cannot be ascribed a narrow or constricted meaning. If we were ITA 687/09 & Ors Page 24 of 38 to

accept the submission made on behalf of the assessees then sub-section (1) would have to be read as follows:-

> ***"For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee with the main object of earning income which does not form part of the total income under this Act."***

That is certainly not the purport of the said provision. The expression "in relation to" does not have any embedded object. It simply means "in connection with" or "pertaining to". If the expenditure in question has a relation or connection with or pertains to exempt income, it cannot be allowed as a deduction even if it otherwise qualifies under the other provisions of the said Act. In Walfort (supra), the Supreme Court made it very clear that the permissible deductions enumerated in sections 15 to 59 are now to be allowed only with reference to income which is brought under one of the heads of income and is chargeable to tax. The Supreme Court further clarified that if an income like dividend income is not part of the total income, the expenditure/deduction related to such income, though of the nature specified in sections 15 to 59, cannot be allowed against other income which is includable in the total income for the purpose of chargeability to tax.

"expenditure incurred"

26. It was contended by the learned counsel for the assessees that the words "expenditure incurred" as appearing in section 14A(1) clearly mean that there must be actual expenditure. Of course, the actual expenditure must be for earning the exempt income. We have already pointed out above, that we do not subscribe to the narrow interpretation sought to given to the words "in relation to" which the learned counsel for the assessees are espousing. Thus, we will have to consider the argument of the asssessees in respect of the expression "expenditure incurred" in the context of the ITA 687/09 & Ors Page 25 of 38 expenditure being in connection with or pertaining to income which does not form part of the total income under the said Act.

27. A reference was made to the decision of the Punjab & Haryana High Court in the case of CIT-II v. Hero Cycles Ltd [ITA No. 331/2009 (O&M): decided on 4/11/2009] wherein it was observed that:-

> ***"Disallowance under Section 14A requires finding of incurring expenditure where it is found that for earning exempted income no expenditure has been incurred, disallowance under Section 14A cannot stand."***

"28. It was contended that unless and until there was actual

expenditure for earning the exempted income, there could not be any disallowance under section 14A. While we agree that the expression 'expenditure incurred' refers to actual expenditure and not to some imagined expenditure, we would like to make it clear that the 'actual' expenditure that is in contemplation under section 14A(1) of the said Act is the 'actual' expenditure in relation to or in connection with or pertaining to exempt income. The corollary to this is that if no expenditure is incurred in relation to the exempt income, no disallowance can be made under section 14A of the said Act."

10. Having regard to the observations made hereinabove, we are of the opinion that the impugned judgment of the Tribunal, which is entirely based on a view held in the case of the assessee pertaining to assessment year 1994-1995, would require reconsideration. We accordingly, set aside the impugned judgment and remand the matter to the Tribunal to examine the same in the light of the observations of this court in ***Maxopp Investments Ltd.*** (*Supra*). We have adopted this course so that the revenue's interest does not get impacted in the subsequent years, as the issue seems to be of a recurrent nature. It is this reason alone which has prompted us to take the second option. We make it clear that on remand parties will be free to address arguments on all issues, including on the aspect of re-assessment in view of observations made in paragraph 3 of the impugned judgment.

11. However, before we conclude we must record our displeasure in the manner in which the revenue has prosecuted the aforementioned appeals.

Therefore, in our view, so that corrective measures are taken at the earliest, a copy of this order should be placed before the Chairman, CBDT. The Chairman, CBDT should direct conduct of an enquiry into the delay caused in obtaining the judgment of the Tribunal for assessment year 1994-95 . The inquiry should be completed within a period of two months from today. The report of the inquiry and the action taken on it be placed on the record of the court before the date fixed for compliance.

12. The appeals are disposed of.

13. List for compliance on 03.02.2012.

RAJIV SHAKDHER, J

SANJAY KISHAN KAUL,J

DECEMBER 12, 2011
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