

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

**INCOME TAX APPEAL NO.1521 OF 2017
WITH
INCOME TAX APPEAL NO.1504 OF 2017
WITH
INCOME TAX APPEAL NO.1523 OF 2017
WITH
INCOME TAX APPEAL NO.1524 OF 2017**

Principal Commissioner of Income Tax (Central)-4 ... Appellant

V/s.

M/s. Ashok Apparels Pvt. Ltd.

... Respondent

Mr.Tejveer Singh for the Appellant.

Mr.Percy Pardiwalla, Senior Counsel with Mr.Madhur Agrawal
i/by Mr.Atul Jsani for the Respondent.

**CORAM : AKIL KURESHI AND
SARANG V. KOTWAL, JJ.
DATE : APRIL 8, 2019.**

P.C.:-

1. These appeals arise in common background. They have been heard together and would be disposed of by common order. From convenience we may refer facts from Income Tax Appeal No.1521 of 2017.

2. This appeal is filed by the revenue to challenge the judgment of Income Tax Appellate Tribunal (“Tribunal” for short). Following questions have been presented for our consideration:-

“a. Whether on the facts and in the circumstances of the case and in law, ITAT was justified in deleting the disallowance made u/s 14A of Rs.16.76 lakhs ignoring the fact that the assessee failed to demonstrate the exact availability of the interest free funds available in hand at the time of making the said investments?

b. Whether on the facts and in the circumstances of the case and in law, ITAT was justified in treating the Bonus Shares as investments with a cost of acquisition of Rs.Nil for the Year under consideration, ignoring the fact that the original shares, for which bonus shares were allotted, were present in the trading stock itself for the year under consideration, thus the Bonus shares allotted against the same, were too required to be treated as a part of trading stock itself?”

3. Question (a) pertains to disallowance of expenditure incurred by the assessee for earning exempt income in terms of Section 14A of the Income tax Act, 1961 (“the Act for short). The Tribunal while deleting such disallowance, for the assessment years 2006-07, 2008-09 and 2009-10 made following observations:-

“9. We have heard the rival submissions, perused the relevant findings given in the impugned orders. So far as the disallowance of interest in all the assessment years, we find that as far as assessment years 2006-07, 2008-09 and 2009-10 are concerned, there are surplus/interest free funds available with the assessee which was more than the investments made during the year, which is quite apparent from the chart reproduced herein above. Once the surplus/interest free funds are excess of investment made, then in view of the ratio and principle laid down by the Hon'ble Bombay High Court in above two cases (Reliance Utilities and HDFC Bank) as relied upon by the ld. counsel, no disallowance under section 14A on account of interest expenditure should be made. Their Lordships have clearly opined that, once in the Balance sheet the assessee has reflected surplus/own funds and also interest bearing funds, then presumption is that, investments must have been made out of interest free funds only and once that is so, then no disallowance of interest should be made. As can be seen from the chart incorporated above, for the AYs 2006-07, 2008-09 and 2009-10, there are excess of interest free/surplus funds over the investments, therefore, no interest disallowance should be made under section 14A for the assessment years 2006-07, 2008-09 and 2009-10 should be made. We order accordingly.”

4. In relation to the assessment year 2007-08, giving rise to the Income Tax Appeal No.1504 of 2017 filed by the revenue, the Tribunal restricted the disallowance by making following observation :-

“10. So far as disallowance of interest under section 14A for the assessment year 2007-08 is concerned, we find that amount of Rs.11,67,88,228/- is excess of investment over interest free funds, that is interest bearing funds are more than the investments, therefore, on same logic and reasoning the disallowance of interest should be made after taking figure of Rs.11,67,88,228/-. However, if such a disallowance exceeds the exempt income of Rs.25,27,123/-, then same should be restricted to the exempt income only, in view of Delhi High Court judgment in Cheminvest Ltd. vs. CIT, reported in (2015) 378 ITR 33. Thus, with this direction the impugned issue of disallowance of interest under section 14A in AY 2007-08 is treated as party allowed.”

5. It can thus be seen that in first set of facts, the Tribunal found that the assessee had interest free funds in excess of the investments made for the purpose of earning exempt income. In that view of the matter, the Tribunal referred to and relied upon the decisions of this Court in case of **Commissioner of Income-Tax Vs. Reliance Utilities and Power Ltd.**¹ and **Commissioner of Income Tax Vs. HDFC Bank Limited**². In case of **Reliance Utilities and Power Ltd. (supra)** the Court had held that if there are funds available both interest free and interest bearing, then presumption would arise, that investment would be

1 (2009) 313 ITR340 (Bom)

2 (2014) 366 ITR 505 (Bom)

out of interest free funds available with the company. If interest free funds were sufficient to meet such investment, no disallowance would be made.

6. In case of HDFC bank, this view was reiterated. After referring to the decision in case of **Reliance Utilities and Power Ltd. (supra)** the Court observed that the Tribunal had come to the factual finding that the assessee had its own funds and that such non-interest bearing funds were in excess of investments in tax free securities. In such circumstances, the Court held that disallowance under Section 14A could not have been made.

7. The facts are similar in the present case. The Tribunal therefore, correctly deleted the disallowance in three out of four assessment years and restricted the same in forth year to the extent the investments exceeded the interest free funds. Learned counsel for the Department however submitted that the assessee failed to demonstrate that in the present year only interest free funds were diverted for making tax free investment. In our opinion as held by this Court in above two decisions the assessee

was not expected to establish the same. Once the presumption that the interest free funds were utilized for making exempt investment, it would be for the revenue to establish to the contrary which in the present case has admittedly not been done.

8. Question (b) as framed does not bring out the controversy with a degree of precision. Having heard learned counsel for the parties and having perused documents on record, we gather that the assessee was holding certain shares of a company by way of stock in trade. The assessee received bonus shares which the assessee claim would be treated as its investments. The revenue argues that the bonus shares have been received out of the shares held by the assessee as stock-in-trade, would automatically partake the character of stock-in-trade in the hands of the assessee. The Assessing Officer in his order of assessment, in this respect had held and observed as under:-

“12.6 The submissions of the assessee have been perused carefully. The submissions of the assessee are not acceptable under the clear facts in the case of the assessee. The facts and circumstances of the case are discussed hereunder.

- (i) The assessee received the BONUS shares during the period it held the original shares. The original shares were the trading stock. Therefore the bonus shares are necessarily the trading stock and not investment stock due to the basis origin of the shares being trading stock.
- (ii) Therefore when the BONUS shares are sold, the character of the same remains the same i.e. Trading stock.”

9. The Tribunal by the impugned judgment held in favour of the assessee by referring to and relying upon the judgment of the Supreme Court in case of **Commissioner of Income-Tax, U.P. Vs. Madan Gopal Radhey Lal¹**.

10. In this respect, the counsel for the revenue submitted that the assessee was holding the shares by way of stock-in-trade. When the company declared bonus shares which the assessee received, it claimed that the shares were held as investment. Counsel submitted that this was a colourable device applied by the assessee to avoid legitimate tax.

11. On the other hand, learned counsel for the assessee opposed

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the appeal contending that the issue is clearly covered by the decision of the Supreme Court in case of **Madan Gopal Radhey Lal (supra)**. There is nothing on record to suggest that the assessee had engaged himself in business in relation to the bonus shares.

12. A very similar situation was examined by the Supreme Court in case of **Madan Gopal Radhey Lal**. It is also a case where the assessee was holding certain shares for the purpose of business. These shares gave rise to bonus shares which the assessee received and treated them as his investment. The revenue objected to this position. Full bench of Allahabad High Court held in favour of the assessee. At the hands of the revenue the issue reached the Supreme Court. The Supreme Court referring to a decision of the House of Lords in case of **Commissioners of Inland Revenue Vs. John Blott**¹ held and observed as under:-

“The principle of the case was affirmed by the Judicial Committee in a case arising under the Indian Income-tax Act, 1922, *Commissioner of Income-tax V. Mercantile Bank of India*. Accordingly,

1 (1921) 8 T.C.101 (H.L.)

bonus shares given by a company in proportion to the holding of equity capital by a shareholder are, in the absence of any express provision to the contrary, liable to be treated as capital and not income.

We are unable to agree with the judgment of the Bombay High Court (to which reference was made by the Tribunal) in Commissioner of Income-tax v. Maniklal Chunnilal and Sons Ltd. (I.T. Reference No.16 of 1948) that bonus shares received by a shareholder who carries on business in shares and securities “ipso facto become accretion to his stock-in-trade.” Bonus shares would normally be deemed to be distributed by the company as capital and the shareholder receives the shares as capital. The bonus shares are accretions to the shares in respect of which they are issued, but on that account those shares do not become stock-in-trade of the business of the shareholder. A trader may acquire a commodity in which he is dealing for his own purposes and hold it apart from the stock-in-trade of his business. There is no presumption that every acquisition by a dealer in a particular commodity is acquisition for the purpose of his business; in each case the question is one of intention to be gathered from the evidence of conduct and dealings by the acquirer with the commodity.

Bonus shares having been received by the assesseees in respect of their stock-in-trade did not, therefore, become part of their stock-in-trade, merely because they were accretions to the stock-in-trade. The bonus shares were received as capital; they could be converted by the assesseees into their stock-in-trade or retained as their capital asset.”

13. We do not think any distinction is possible to be made in

the present case. The facts are virtually identical. As observed by the Supreme Court in the said case shares given by company in proportion to the holding of equity capital by share-holders would, in the absence of express provision to be contrary be treated as capital and not income. The Assessing Officer has merely proceeded on the basis that the origin of the bonus shares being the shares held by the assessee by way of stock-in-trade, necessarily the bonus shares would also partake the same character.

14. In the result, we do not find any questions of law arising. All the appeals, therefore, dismissed.

(SARANG V.KOTWAL,J.)

(AKIL KURESHI,J.)

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