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

R-5A

\+ **ITA 784/2005**

THE COMMISSIONER OF INCOME TAX ..... Appellant

Through: Mr Sanjay Kumar, Advocate.

versus

M/S. SAW PIPES LTD. ..... Respondents

Through: Ms Kavita Jha with Ms Devika Jain, Advocates.

. **CORAM:**
JUSTICE S.MURALIDHAR
JUSTICE I.S.MEHTA

<u>O R D E R</u>

% 15.04.2019

1. This is an appeal by the Revenue against an order dated 20th April, 2005 of the Income Tax Appellate Tribunal ('ITAT') in ITA No.2309/Del/2004 for the Assessment Year ('AY') 2000-01.

2. While admitting the appeal on 5th September, 2005, the following question of law was framed:

> "Whether in the facts and circumstances of the case, the Commissioner of Income-tax was right in exercising his powers under Section 263 (1) of the Income-tax Act, 1961?"

3. The Assessee filed its return, declaring a total loss of Rs. 14,45,87,240/- for the AY in question and a revised return on 28th March, 2002 showing income from business and profession as 'Nil'.

4. The return was picked up for scrutiny under Section 143 (3) of the Act. An assessment order dated 31st March 2003 was framed by the Assessing Officer

('AO'), after examining the details provided by the Assessee. The AO considered the following issues in the assessment order

"i) Capitalization of interest for setting up of its new plant.
ii) Allowability of deferred business expense claimed at Rs.85 lacs.
iii) Capitalization of royalty payment.
iv) Allowability of contribution to superannuation funds after due date of payment.
v) Allowability of the wealth tax paid under Income tax Act."

5. The Commissioner of Income Tax ('CIT') decided to exercise the jurisdiction under Section 263 of the Act and issued a show cause notice ('SCN') dated 30th January, 2004 to the Assessee. The issues on which the SCN was issued were as follows:

"(i) Allocations of expenses under Section 14A for the exempt dividend under section 10(33) of the Act.
(ii) Allowability of payments under Section 43B.
(iii) Undervaluation of closing stock.
(iv) Bad debts written off.
(v) The nexus of the borrowed funds and payments of interest thereon with the money advanced as loan.
(vi) Commission on sales."

6. By the impugned order dated 23rd March, 2004, the CIT held the assessment made by the AO to be not erroneous and, therefore, not requiring revision in respect of the following issues:

(a) Allowing of the payments under Section 43-B of the Act; and

(b) Bad debts written off.

7. However, in respect of the following issues, the CIT held the order of the AO to be erroneous and prejudicial to the interests of the Revenue:

(i) Exemption under Section 10 (33) in respect of dividend and income;
(ii) Undervaluation of the closing stocks;
(iii) The failure to examine the nexus between the borrowed funds and the monies advanced as loan to its sister concerns; and
(iv) The claim in regard to commission on sales.

8. The CIT accordingly cancelled the assessment order in regard to the above four issues and directed the AO to reframe the assessment after making necessary inquiries. He added that the AO will also be "free to examine any other issues which have not been covered in this order except those issues which have already been considered and decided by the CIT (Appeals)".

9. The Assessee assailed the above order of the CIT before the ITAT. By the impugned order the ITAT held that the CIT erred in proceeding on the basis that if necessary inquiries were not undertaken by the AO, the assessment order is automatically erroneous and prejudicial to the interests of the Revenue. The ITAT as held that on account of this basic flaw in the approach, the CIT did not go into the merits of the Assessee's claim to find out if any prejudice had in fact been caused to the Revenue on account of lack of inquiry by the AO. The ITAT held that it was incumbent upon the CIT to have shown as to how the assessment order was prejudicial to the interest of the Revenue and this had to be done on the basis of an assessment of the material on objective criteria.

10. The ITAT then dealt with each of the individual items on which the CIT upset the assessment order. It was held that the mere advancing of loans to subsidiary and other companies would not have a bearing on the question of

deduction of interest from the dividend income. The Assessee had explained that its borrowings were for the earmarked purpose and during the AY in question, the borrowed funds were not used for investment in shares for the succeeding AY i.e. 2001-02, the AO had specifically looked into the applicability of Section 14-A of the Act and had made no disallowance. In the preceding year also, there had been no disallowance on interest against dividend and income. Accordingly, the ITAT did not agree with the CIT on this aspect.

11. As regards the disallowance of interest expenditure, the ITAT examined the balance sheet and came to the conclusion that since the business had to be run as per the decision of the Assessee and not as per the whims and fancies of the authorities, the CIT could not have formed an opinion whether certain investment could be termed as 'bad'. The Assessee's act of declaration of interest income of Rs.12.94 crore on monies advanced to Hexa Securities could therefore not said to be prejudicial to the interest of the Revenue. The submission of the Assessee that all loans were earmarked and could not be utilized for investment or giving loans, was accepted. The ITAT also accepted the plea of the Assessee that it had interest free funds of Rs.209.74 crore, which would take care of the investment in shares to the extent of Rs.67.22 crore, and interest free lending of funds at lower rates.

12. As regards the issue under Section 43-B of the Act, it was noted that CIT himself had clearly stated that the assessment order in this regard could not be said to be erroneous or prejudicial, as was the case of bad debts.

13. The ITAT then dealt with the issue of valuation of closing stocks and

noticed that the Assessee had made changes in the method of valuation consistent with the accounting standards prescribed by the ICAI. Therefore, no prejudice was caused to the Revenue by that change. Lastly, on the issue of payment of commission, the ITAT found that the AO had obtained a written explanation from the Assessee during the assessment proceedings and, therefore, it could not be said that the AO did not make any enquiry while allowing this commission payment as a deduction.

14. This Court has heard the submissions of Mr Sanjay Kumar, learned counsel appearing for the Revenue and Ms Kavita Jha, learned counsel appearing for the Assessee.

15. On the first issue of disallowance under Section 14-A of the Act, in respect of dividend income of Rs.46, 87,862/-, the CIT appears to have proceeded on the basis that “there was significant change in the Assessee's investments in shares during the previous year under consideration in as much as 3,48,717 shares of Jindal Steel & Power valued at Rs. 5.44 crores were acquired by the assessee and its shareholding in Jindal Strips Ltd. was reduced from 8,71,793 shares as on 31st March, 1999 to 5,23,076 as on 31st March, 2000.” Also the CIT observed that “a substantial part of this investment was made by taking inter-corporate loans which increased from Rs. 22.91 crores as on 31st March,1994 to Rs.110.85 crore as on 31.3.1995 (the relevant papers, which were filed by the Assessee during the assessment proceedings for that assessment year were shown to the Assessee's representatives during the hearing on 16th March, 2004). This investment included the investment in shares of Hexa Securities & Finance Co. Ltd., a·

subsidiary company, amounting to Rs. 25 crores and in shares of Jindal Vijaynagar Steel Ltd. amounting to Rs.5 crores. Both these investments, acquired out of inter-corporate loans, have continued to remain with the Assessee during the previous year relevant to the assessment year under consideration also."

16. The ITAT has found that factually the CIT was in error in coming to the above conclusion. On examining the Schedule of Investment given in the Assessee's balance sheet, the ITAT found that "shares have increased and decreased due to business reorganization and not due to any purchase and sale of shares". Further, as rightly pointed out by the ITAT, the CIT did not find that the Assessee utilized the whole of the borrowings of Rs.110.85 crore made in AY 1995-96 towards investment shares in that year, although the Assessee maintained that it used such borrowings for other business purposes also and investment to the extent of Rs.67.22 crore was utilized out of such borrowed funds. A substantial portion of the borrowings stood repaid in the preceding year out of internal accruals. The question that had to be answered was whether the Assessee had made any investment out of the borrowed funds in the AY in question i.e. 2000-01. On this specific aspect, the ITAT found that there is merit in the Assessee's contention that "all its present borrowings" were for 'earmarked purposes' and "none of them was for investment in shares". The ITAT also followed the rule of consistency after noticing that in the previous years and in the immediate succeeding AY 2001-02, no disallowance was made under Section 14-A of the Act.

17. Having heard the learned counsel for the parties and having examined the

record carefully, this Court is not persuaded to come to a conclusion different from the one reached by the ITAT, which purely turned on facts. Indeed the CIT appears to have proceeded on surmises that the investment in shares was out of borrowed funds of the Assessee when plainly it was not.

18. The ITAT has also examined carefully the issue of disallowance of interest expenditure. This was not a case where the Assessee had advanced funds interest free. The details had been filed about the borrowings which showed that it was at 13 to 17.86% interest whereas the lending of the monies was @ 16%. The main lending was to Hexa Securities Finance Company Limited. Some money had also been lent to Padmini Holdings Pvt. Ltd. @ 15% and Equipment & Leasing Ltd., @13.2%. The ITAT importantly found that the AO did examine this issue. By a letter dated 14th January, 2003, he had called for the relevant information from the Assessee and the Assessee had filed such information with the AO. The secured loans were indeed earmarked and could not be utilized for making investments or advancing further loans. Further, the Assessee had its own interest free funds of Rs.209.74 crore which could easily take care of the investment in the shares of Rs.67.22 crore, apart from lending funds at lower rates to the subsidiaries. In the circumstances, the Court concurs with the view expressed by the ITAT that this issue did not require to be revisited under Section 263 of the Act.

19. On the issue of valuation of stock, the Assessee had explained the difference in the values by pointing out that 91% of its stocks comprised of the goods meant for export whereas 80% of the sales during the year were for

the domestic market. Inasmuch as the export sales do not have an element of excise duty, the prices in the domestic market were higher. Further the stock comprised of various grades and therefore the prices could not be worked out by merely dividing the total quantity with the sale value. The ITAT found that approach of the CIT and that its conclusion that there was an error in valuation of closing stock was neither correct nor justified. Point No.8 of Schedule 22 of the Assessee's balance sheet contained the disclosure in this regard and this change was consistent with the accounting standards prescribed by the ICAI. On this aspect also, the view taken by the ITAT appears to be justified and does not call for interference.

20. On the issue of payment of commission, the ITAT found that it had to be inquired into by the AO. He had obtained a written explanation on non reduction of TDS on commission payment to non-resident parties. The ITAT found nothing unusual about the commission payment. Importantly, this was not a case where the AO had not made any inquiry.

21. For all of the aforementioned reasons, the Court finds that the impugned order of the ITAT suffers from no legal infirmities, requiring any interference. The question of law is accordingly answered in the negative i.e. in favour of the Assessee and against the Revenue. The appeal is accordingly dismissed.

S.MURALIDHAR, J.

I.S.MEHTA, J.

APRIL 15, 2019/*rd*