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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
+ **ITA 599/2018, C.M. APPL.21050/2018**
+ **ITA 648/2018, C.M. APPL.22920/2018**
+ **ITA 655/2018**

COMMISSIONER OF INCOME TAX Appellant
Through : Sh. Ajit Sharma, Sr. Standing Counsel.
versus
ALPHA G. CORP DEVELOPMENT LTD. Respondent
Sh. Debesh Panda, Sh. V.D. Verma and Ms. Akriti
Kataria, Advocates, for respondents.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE PRATEEK JALAN

ORDER
% **25.04.2019**

The question of law framed by this Court in all the three appeals is as follows:

"Did the Income Tax Appellate Tribunal (ITAT) fall into error in holding that the disallowance under Section 14-A of the Income Tax Act was not warranted because the underline investment was for strategic purposes? "

During the concerned Assessment Years (AYs) 2008-09, 2011-12 and 2012-13, the assessee/respondent earned tax exempt income. When called upon to explain why disallowance should not be made under Section 14-A of the *Income Tax Act, 1961* [hereafter "the Act"] during the assessment proceedings, it was contended that no expenditure was actually incurred on earning exempt income. The assessee also revealed that sums invested in mutual funds and in its subsidiary companies were initially brought in through Foreign Direct Investment (FDI) route and were awaiting use, for the purpose of township development. The assessee

had to obtain several statutory and other clearances to launch this business activity. In the meanwhile, it had invested substantial amounts in mutual funds.

The explanation offered by the assessee to the Assessing Officer (AO) that amounts were invested in subsidiary companies in each of which it had substantial stakes was taken into consideration by the AO who held that dividend income earned through dividend declared by such subsidiaries too was exempt. On appeal before the CIT (A), it became apparent that in fact no dividend was earned and that the only tax exempt income returned was through dividend from mutual funds. The assessee had contended that such dividend or income did not involve any expenditure since they were “legacy investments”. In support, it was contended that the assessee had been formed after some restructuring of a previous existing corporate entity through merger and amalgamation.

The Income Tax Appellate Tribunal (ITAT) rejected the Revenue’s appeal on the ground that income derived through strategic investments, i.e. for the purpose of maintaining minimum or what is deemed to be commercially feasible holding in a subsidiary entity, is exempt. This was based upon the previous understanding of the law. It was in these circumstances that this Court framed the question of law which it did.

In *Maxopp Investment Ltd. v. CIT* (2018) 15 SCC 523, the question – which this Court had formulated in these appeals, was answered in the following terms:

“41. In the first instance, it needs to be recognised that as per section 14-A(1) of the Act, deduction of that expenditure is not to be allowed which has been incurred by the assessee “in relation to income which does not form part of the total income under this Act”. Axiomatically, it is that expenditure alone which has been incurred in relation to the

income which is includible in total income that has to be disallowed. If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would obviously be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure. To put it differently, such expenditure would then be considered as incurred in respect of other income which is to be treated as part of the total income.

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43. Having clarified the aforesaid position, the first and foremost issue that falls for consideration is as to whether the dominant purpose test, which is pressed into service by the assessee would apply while interpreting Section 14-A of the Act or we have to go by the theory of apportionment. We are of the opinion that the dominant purpose for which the investment into shares is made by an assessee may not be relevant. No doubt, the assessee like Maxopp Investment Ltd. may have made the investment in order to gain control of the investee company. However, that does not appear to be a relevant factor in determining the issue at hand. Fact remains that such dividend income is non-taxable. In this scenario, if expenditure is incurred on earning the dividend income, that much of the expenditure which is attributable to the dividend income has to be disallowed and cannot be treated as business expenditure. Keeping this objective behind Section 14-A of the Act in mind, the said provision has to be interpreted, particularly, the word 'in relation to the income' that does not form part of total income. Considered in this hue, the principle of apportionment of expenses comes into play as that is the principle which is engrained in Section 14-A of the Act. This is so held in Walfort Share and Stock Brokers P Ltd., relevant passage whereof is already reproduced above, for the sake of continuity of discussion, we would like to quote the following few lines therefrom (SCC p.151, paras 34 & 36).

“34.The next phrase is, “in relation to income which does not form part of total income under the Act”. It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14-A.

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36. The theory of apportionment of expenditure between taxable and non-taxable (sic income) has, in principle, been now widened under section 14 A.”

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50. 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 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 V. CIT 2011 SCC Online Del 4855 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 at 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 up in order to earn profits. In the result, the appeals filed by the Revenue challenging the judgment of the Punjab and Haryana High Court in CIT v. State Bank of Patiala 2017 (391) ITR 218 (P&H) also fail, though law in this respect has been clarified hereinabove.”

The answer to the question of law framed by this Court, therefore, has to be in the affirmative. The findings and observations made by the Court, however, are not entirely dispositive of this appeal. It is apparent from a reading of the facts in the appeal that the CIT(A) formed an opinion based upon diverse reasoning, having regard to the facts of each case, regarding the nature of expenditure and especially whether it was a one-time investment opportunity availed of by the assessee. This is relevant in the context of assessee's assertion that in fact no expenditure was incurred while investing in the mutual funds that yielded substantial income. As to whether in fact no expenditure was incurred or attributable at all, in these circumstances, it becomes a factual controversy requiring further hearing and scrutiny. On this aspect, therefore, the Court is of the opinion that the task is better performed by the ITAT.

In view of the above discussion, the question of law is answered in favour of the Revenue, but subject to the factual findings recorded above. The matter is remitted to the ITAT for further hearing and findings on the substantive aspect with regard to attributability of expenditure to dividend income earned through the mutual funds in which the assessee invested.

The appeals are partly allowed in the above terms along with the pending applications.

All rights and contentions are kept open.

S. RAVINDRA BHAT, J

PRATEEK JALAN, J

APRIL 25, 2019/AJK