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

WRIT PETITION NO. 2684 OF 2025

Kedaara Captial Fund II LLP .. Petitioner

Versus

Assessment Unit, National Faceless
Assessment Centre (NFAC), Delhi
and Ors. .. Respondents

***Mr. Jehangir Mistry, Senior Counsel**, a/w Mr. Harsh Kapadia and Mr. Sameer Dalal, for the Petitioner.*

***Ms. Mamta Omle**, for the Respondents.*

CORAM: B. P. COLABAWALLA &
AMIT S. JAMSANDEKAR, JJ.
DATE: SEPTEMBER 9, 2025

P. C.

1. Rule. Respondents waive service. With the consent of the parties, Rule made returnable forthwith and heard finally.

2. This petition challenges (i) the assessment order dated 21st March 2025 passed under Section 143(3) read with Section 144B of the Income-tax Act, 1961 (for short “the Act”) for A.Y. 2022-23; (ii) the consequential demand notice issued under Section 156; and (iii) the penalty show cause notice issued under Section 274 of the Act.

3. At the outset it is stated that as the limitation period for filing an appeal before the Commissioner of Income Tax (Appeals) under Section 246A of the Act was expiring, the Petitioner, out of abundant caution and in an earnest attempt to safeguard against any potential risks and prejudice, filed an appeal on 19th April 2025, i.e., after lodging the present Writ Petition.

4. The relevant facts are as follows:-

4.1. The Petitioner is registered with SEBI as a Category II AIF – closed ended fund under the SEBI (AIF) Regulations, 2012. It carries on investment activities as permitted under the regulations, but does not undertake any business activities, either in India or outside.

4.2. For the purposes of the Act, the Petitioner is regarded as an 'investment fund' as defined under Section 115UB. Resultantly, any income from investment activities earned is exempt under Section 10(23FBA). Such income is, however, taxable in the hands of the unit holders of the Petitioner. In other words, assessees like the Petitioner are granted a pass-through status under the Act.

4.3. During the year, the Petitioner implemented investments aggregating to Rs. 1,300.27 Crores using the capital raised from its unit holders. The total portfolio investments of the Petitioner as on 31st March 2022 is Rs. 8,665.75 Crores. It is an undisputed fact that the Petitioner neither sold any of the investments during the year nor did it earn any income from such investment activities. The only income earned by the Petitioner during the year was short term capital gains of Rs. 0.99 Crores on cancellation of certain forward contracts.

4.4. The total expenses incurred by the Petitioner during the year was Rs. 118.99 Crores. In the books of accounts maintained, these expenses were debited to the statement of profit and loss for the year.

4.5. The Petitioner filed its Return of Income for the subject A.Y. 2022–23, declaring Rs. NIL income. Further, in such return, the income of short term capital gains of Rs. 0.99 Crores was claimed as exempt under Section 10(23FBA) read with 115UB and taxable in the hands of the unit holders.

4.6. Insofar as the expenses of Rs. 118.99 Crores incurred during the year, the Petitioner states that no deduction whatsoever was claimed of such an amount. It is also stated that no carry forward of any loss under any head of income was claimed by the Petitioner. Moreover, it is also stated that a deduction of such an amount has also not been claimed by any of the unit holders as well.

4.7. During the assessment proceedings, various notices were issued by the Assessing Officer, which were duly responded to. After considering all submissions, the impugned assessment order was passed on 21st March 2025. The AO disallowed expenses of Rs. 103.15 Crores (expenses incurred towards management fees and other related costs of Rs. 15.84 Crores paid to its investment advisor, Kedaara Capital Advisors LLP, were allowed by the AO) and added the said amount under the head "profits and gains from business and profession" to the total income of the Petitioner. This amount is added by the AO on the ground that the expenses were "neither found genuine nor any income has offered against these expenses". The reasoning of the AO is:

- Non genuine expenses were allocated by the Petitioner to unit holders as unrealised gains;

- Except management fees, other expenses were not related to the purpose of the AIF;

- In respect of the personnel cost of Rs. 93.41 Crores, the Petitioner failed to substantiate it with documentary evidence;

- The Petitioner claimed total expenses of Rs. 118.99 Crores, i.e., 9.15% of the total investments made during the year, which, according to him, were unreasonable;

- According to the AO, salaries were paid to persons who were linked with entities in which the Petitioner had invested;

- Claim of other expenses were not supported by documentary evidence, and the Petitioner failed to justify as to why they were incurred.

4.8. A notice of demand under Section 156 of the Act raising a tax demand of Rs. 49.02 Crores, as well as a penalty show cause notice, are also issued pursuant to the above assessment order.

5. It is in this backdrop that the present Writ Petition challenges the above order and the consequential notices issued by the AO. Amongst other grounds, the primary challenge is on the ground that the AO has added expenses to the Petitioner's total income despite the fact that no deduction in respect of such expenses has been claimed either by the Petitioner or the unit holders, and, therefore, the question of adding such an amount could never

have arisen. This aspect of the income tax law is fundamental. The addition made therefore, is wholly without jurisdiction, perverse and arbitrary. The AO miserably overlooked the fact that the Petitioner has been granted a pass-through status under the Act, and therefore, assuming for the sake of argument that the Petitioner incurred non-genuine expenses, nevertheless, such an addition could not have been made in the hands of the Petitioner. In any case, the AO has clearly misconceived and misjudged the provisions of law entirely. Firstly, the unrealised gains reported in the financial statements of the Petitioner as 'surplus' does not constitute 'income' of the unit holders and is not taxable in their hands under Section 115UB. Such unrealised gains allocated to the unit holders is a notional amount reported merely from an accounting standpoint, and such notional amount is not taxable in either the hands of the Petitioner or unit holders. Therefore, allocation of so-called surplus has no bearing on the income of the unit holders or the Petitioner. Secondly, in any case, it is a well-settled principle of income tax law that to determine the taxability of a particular item is not governed by how that item is treated by the counterpart assessee. Therefore, the treatment given in the hands of the unit holders cannot govern how the income of the Petitioner is to be determined. Accordingly, it is submitted that the addition made by the AO is completely unlawful, without jurisdiction and illegal.

6. On the other hand the contention of the counsel for the Respondents, are as under:

(i) The Writ Petition ought not to be entertained as the Petitioner has an alternative remedy under the Act by way of an appeal before the CIT(A), which the Petitioner has in fact exercised;

(ii) The Petitioner's argument that no deduction has been claimed in respect of the expenses has been considered by the AO and rejected on the ground that the statement of profit and loss clearly established that non genuine expenses were in fact allocated to the unit holders;

(iii) Alternatively, the matter be remanded back to the AO to reconsider the Petitioner's contentions.

7. We have heard learned Counsel for the parties. We have also perused the papers and proceedings in the above Writ Petition.

8. On the first objection of the Revenue that the Writ Petition ought not to be entertained because there is an alternate remedy available to the Petitioner, we find that in the peculiar facts and circumstances of this case, this Court can exercise its discretion under Article 226 of the Constitution of

India and interfere in the above matter when an assessment order is completely illegal, contrary to the clear mandate of law would be, in our opinion, at least *prima facie*, without jurisdiction.

9. Further, it is well settled that the jurisdiction of the High Court in entertaining the Writ Petition, despite alternate statutory remedies, is not affected in a case where the authority against whom the Writ is filed has usurped its jurisdiction without any legal foundation. Not entertaining a Writ Petition where statutory remedies are available, is really one of self-restraint, and it can never be argued that the Writ Petition is not maintainable. We, therefore, do not find any merit in the first argument canvassed on behalf of the Revenue.

10. Having said this, we find that the merits of the matter certainly require interference under Article 226 of the Constitution of India. In the facts of the present case, it is undisputed that the addition of expenses (of Rs.103.15 Crores) made by the Assessing Officer in the impugned order was never ever claimed as a deduction by the Petitioner in its Return of Income. In other words, these expenses were never claimed as a deduction to give rise to the Assessing Officer to add back those deductions in the Income Returned by the Petitioner. In our humble opinion, the Assessing Officer wrongly relied

on the accounting treatment to make the aforesaid addition. He failed to recall the well-established principle of law that treatment given by the Assessee in its books of account is not decisive/conclusive for determining the taxable income under the Act. Whether an Assessee is entitled to a deduction or not entirely depends upon the provisions of the Act *de hors* the disclosure in its books of account. This has been clearly held by three different decisions of the Hon'ble Supreme Court in the case of ***Kedarnath Jute Manufacturing Company Ltd. v. CIT [(1971) 82 ITR 363 (SC)], Taparia Tools Ltd. v. JCIT [[2015] 55 taxmann.com 361 (SC)] and United Commercial Bank v. CIT [(1999) 240 ITR 355 (SC)]***.

11. We, therefore, are of the humble opinion that the addition of Rs.103.15 Crores made by the Assessing Officer in the Income Returned by the Petitioner is wholly unsustainable.

12. As far as the request made for remanding the matter back to the Assessing Officer is concerned, we find that there is no conceivable ground that has been brought on record based on which the request for remand has been made by the learned Advocate appearing for the Revenue. It is not as if the Assessing Officer was unaware that no deduction has been claimed by the

Petitioner. During the assessment proceedings, on more than half a dozen occasions, the Petitioner had highlighted this fact. Nevertheless, the Assessing Officer proceeded to make the aforesaid addition, and that too by relying upon the treatment given in the books of account of the Petitioner/Assessee. Therefore, the addition made was a conscious act of the Assessing Officer and cannot be regarded as an error/oversight which would entail a remand. Accordingly, we are of the view that no purpose would be served if the matter is remanded to the Assessing Officer for a fresh consideration.

13. In view of the aforesaid discussion, the impugned assessment order dated 21st March 2025, passed for Assessment Year 2022-23, is hereby quashed and set aside along with the consequential demand notice (issued under Section 156 of the Act) and the penalty show cause notice (issued under Section 274 of the Act).

14. Rule is made absolute in the aforesaid terms, and the Writ Petition is also disposed of in the terms thereof. However, there shall be no order as to costs.

15. This order will be digitally signed by the Private Secretary/ Personal Assistant of this Court. All concerned will act on production by fax or email of a digitally signed copy of this order.

[AMIT S. JAMSANDEKAR, J.] **[B. P. COLABAWALLA, J.]**

Darshan Patil