IN THE INCOME TAX APPELLATE TRIBUNAL
AMRITSAR BENCH; AMRITSAR.

BEFORE SH. SANJAY ARORA, ACCOUNTANT MEMBER
AND SH. N. K. CHOUDHRY, JUDICIAL MEMBER

I.T.A. No. 218(Asr)/2017
Assessment Year: 2012-13

Lally Motors India (P.) Ltd., Civil Lines, Jalandhar. [PAN: AABCL4446M]	Vs.	The Principal Commissioner of Income Tax-2, Jalandhar.
(Appellant)		**(Respondent)**

Appellant by : Sh. Sameer Bhatia (Adv.)
Respondent by: Sh. Bhawani Shankar (D. R.)

Date of Hearing: 15.01.2018
Date of Pronouncement: 12.04.2018

ORDER

Per Sanjay Arora, AM:

This is an Appeal by the Assessee agitating the Order by the Pr. Commissioner of Income Tax-2, Jalandhar ('Pr. CIT' for short, or the competent authority) dated 29.03.2017, directing a revision of the assessee's assessment u/s. 143(3) of the Income Tax ('the Act' hereinafter) for Assessment Year (AY) 2012-13 vide order dated 31.12.2014.

2. The question arising in the instant appeal is if the provision of section 263 of the Act stands rightly invoked in the facts and circumstances of the case.

3. The brief facts of the case are that the Assessing Officer (AO) during the course of assessment proceedings queried the assessee on the applicability of section 14A in view of investment in shares (in Gautam Iron Mills Pvt. Ltd., at Rs. 3.02 crore, as on 31.03.2012 - the year-end.) The assessee replied by stating that it had not earned any income by way of dividend on the said shares, for section 14A of the Act to apply. Reliance was placed on the decision in *Cheminvest Ltd*. (in ITA No. 794/2014, dated 02/9/2015) by the Hon'ble Delhi High Court. Two, it had not incurred any expenditure in relation to the said investment in shares, so that section 14A would even otherwise not apply. The AO completed the assessment accepting the assessee's contentions. The ld. Pr. CIT, subsequently observed the following facts on a perusal of the assessee's balance-sheet, forming part of the assessment record (refer para 3 of the impugned order):

> "3. I have considered the facts of the case and the provisions of the law with regard to the section 263 of the Income Tax Act, 1961. On perusal of the balance sheet of the assessee the following facts are note worthy:-
>
> ***(a)*** The assessee has negative net worth of Rs. 7.7 crores as on 31.03.2012 and Rs. 1.6 crores on 31.03.2011.
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> ***(b)*** The borrowed funds of the assessee as on 31.03.2012 are roughly Rs. 11 crore; on which interest of Rs. 3.59 crores has been debited in the profit & loss account.
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> ***(c)*** Further, the assessee has debited administrative expenses of Rs. 2.36 crore in its Profit & Loss account.
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> ***(d)*** The total investment in the shares of M/s Gautam Iron Mills Pvt. Ltd., as on 31.03.2012, is Rs. 3.07 crores, constituting the 97% of the share capital of the company."

The assessee was accordingly show caused by him in the matter u/s. 263, to which it submitted likewise, i.e., as in the assessment proceedings. The ld. Pr. CIT was, however, not impressed. Circular No. 5/2014 by the Board, reproduced at para 3.5 of his order, had in no uncertain terms clarified that section 14A would apply even if the no tax-exempt income (i.e., income not forming part of the total income) had in fact been earned, i.e., as long as expenditure is incurred for earning such income. The said Circular, binding on the A.O., was in fact not brought to the notice of the Hon'ble Court, so that the decision would require reconsideration, being even otherwise not binding on the A.O. Further, the firm has negative net worth during the relevant year, so that the entire investment stands financed by borrowed capital and, besides, administrative expenditure in the sum of Rs.2.36 crores had been incurred by the assessee. The contention that no expenditure had been incurred *qua* the investment in shares was therefore not acceptable. *Explanation 2* to section 263, inserted by Finance Act, 2015 w.e.f. 01.06.2015, deems that an order by the AO, passed, in the opinion of the Principal Commissioner or Commissioner, not in accordance with any order, directions or instructions issued by the Board u/s. 119 of the Act, is erroneous in-so-far as it is prejudicial to the interest of the Revenue. The assessee's argument that the investment under reference was strategic – raised before him for the first time, was met by the ld. Pr. CIT with reference to the decision by the Tribunal in *Voltech Engineers Pvt. Ltd. v. Dy. CIT* [2017] 49 CCH 0488 (Chennai). He, accordingly, set aside the assessment to the limited extent of examination of the issue of disallowance u/s. 14A *qua* the investment in shares in Gautam Iron Mills Pvt. Ltd. afresh, and in light of the Board Circular 5/2014 (para 4 of the impugned order). Aggrieved, the assessee is in appeal.

4. We have heard the parties, and perused the material on record.

4.1 Our first observation in the matter is a complete absence of any examination by the A.O. *qua* the aspect of incurring of expenditure by the assessee-company in relation to the investment/s yielding (or liable to yield) tax-exempt income, which, in-so-far as it relates to the investment in Gautam Iron Mills Pvt. Ltd., is apparent from a bare browse of the assessee's final accounts, i.e., the balance-sheet and profit and loss account for the relevant year. Incurring such expenditure is a *sine* *qua non* for the invocation of section 14A, the premise of which is to determine correctly the income chargeable to tax, i.e., the income forming part of the total income, returned by the assessee at Rs. 130.16 lacs. The assessee, neither before the ld. Pr.CIT nor before us disputes the factual observations by the competent authority, made, as stated with reference to the assessee's final accounts, forming part of the record (refer para 3 above). How could then, we wonder, the inference of the investment in shares being financed by borrowed funds be disputed; the assessee having no positive capital and, in fact, throughout the year, so that its entire assets, including the shares under reference, as is apparent, are financed by borrowed capital, outstanding at nearly Rs. 1100 lacs as on 31/3/2012, and on which it has admittedly incurred interest expenditure at Rs. 359 lacs. How would it matter if the investee company has, as claimed, not undertaken any business during the relevant year, or is a defunct company (on which the AO has issued no finding). No such contentions, i.e., *qua* the investee company being defunct, stands raised before us. A defunct company, assuming so, does not imply an asset-less company, for its' share to have no value at all. The loss of value, not booked in audited accounts, cannot be taken cognizance of. The same is even otherwise a capital loss, so that interest in its respect would not be deductible in computing business income. The only consideration relevant, as we see it, is if the assessee-company has incurred interest expenditure in relation to the said investment. The administration expenditure, incurred at Rs. 2.36 cr., attributable to the said investment, i.e., if any, cannot be inferred from the face of the final accounts, which aspect would require factual verification. Absence of inquiry, where required and warranted in the facts and circumstances of the case, is a valid basis for invocation of section 263, i.e., for exercising revisionary jurisdiction, as per the settled law in-as-much as it reflects non application of mind. The Apex Court in *Malabar Industrial Co. Ltd. vs. CIT* [2000] 243 ITR 83 (SC) laid down a four-way test for orders being erroneous in-so-far as they are prejudicial to the interest of the Revenue, liable for revision, viz. incorrect application of law; wrong assumption of fact/s; non-observance of the principles of natural justice; and lack of inquiry. Decades earlier, the Hon'ble Delhi High Court in *Gee Vee Enterprises vs. CIT (Addl.)* [1975] 99 ITR 375 (Del), following two decisions by the Apex court, explained the proposition thus:

> *'It is not necessary for the Commissioner to make further inquiries before cancelling the assessment order of the Income-tax Officer. The Commissioner can regard the order as erroneous on the ground that in the circumstances of the case the Income-tax Officer should have made <u>further</u> inquiries before accepting the statements made by the assessee in his return. The reason is obvious. The position and function of the Income-tax Officer is very different from that of a civil court. The statements made in a pleading proved by the minimum amount of evidence may be adopted by a civil court in the absence of any rebuttal. The civil court is neutral. It simply gives decision on the basis of the pleading and evidence which comes before it. The Income-tax Officer is not only an adjudicator but also an investigator. He cannot remain passive in the face of a return which is apparently in order but calls for further inquiry. It is <u>his duty to ascertain the truth of the facts</u> stated in the return when the circumstances of the case are such as to provoke an inquiry. It is <u>because it is incumbent</u> on the Income-tax Officer to further investigate the facts stated in the return when circumstances would made such an inquiry prudent that the word "erroneous' in section 263 includes the failure to make such an enquiry. The order becomes erroneous because such an inquiry has not been made and not because there is anything wrong with the order if all the facts stated therein are assumed to be correct.'*

The principle is well-established, and lack of inquiry renders an order erroneous in-so-far as it is prejudicial to the interest of the Revenue. Case law in the matter is legion, rendered in different fact situations: *CIT (Addl.) vs. Mukur Corporation* [1978] 111 ITR 312 (Guj); *Swarup Vegetable Products vs. CIT* [1991] 187 ITR 412 (All); *Tarajan Tea Co. (P.) Ltd. vs. CIT* [1994] 205 ITR 45 (Gau); *CIT vs. Active Traders (P.) Ltd.* [1995] 214 ITR 583 (Cal); *CIT vs. Mahavar Traders* [1996] 220 ITR 167 (MP); *K.A. Ramaswamy Chettiar vs. CIT* [1996] 220 ITR 657

(Mad); *Mofussil Warehouse & Trading Co. Ltd. vs. CIT* [1999] 238 ITR 867 (Mad); *CIT vs. Export House* [2002] 256 ITR 603 (P&H); *CIT vs. Arunaben Sumankumar* [2003] 259 ITR 386 (Guj); *Pt. Lashkari Ram vs. CIT* [2005] 272 ITR 309 (All); *CIT vs. Deepak Kumar Garg* [2008] 299 ITR 435 (MP); *CIT vs. Toyota Motor Corpn.* [2008] 306 ITR 49 (Del) (affirmed by the apex court, vide its judgment at [2008] 306 ITR 52 (SC)). (also refer: *Rajalakshmi Mills Ltd. v. ITO* [2009] 121 ITD 343 (Ch.)(SB)).

4.2 The second, equally relevant, aspect of the matter is if the provision could be invoked in the absence of any tax-exempt income. Toward this, while the ld. Pr.CIT relies on the Board Circular 5/2014, the ld. Authorized Representative (AR), the assessee's counsel, was during hearing at pains to emphasize that the same stands since 'torn apart' by the Hon'ble High Courts, so that it is bereft of any value. On being asked if the same had been set aside or stayed by any High Court, he would though admit of it being not the case. The question is not which of the two is correct (view) or more correct, but if same is binding on the A.O. as an assessing authority. The reason is simple. The A.O., despite an order by the revisionary authority directing him to do so, cannot pass an order consistent with the Board Circular where the same has been struck down by a competent court, unless, of course, the same stands, at the same time, upheld by the Hon'ble jurisdictional High Court. In fact, even a decision by the said Court (or by the Hon'ble Apex Court) contrary to the dictum of the said Circular, i.e., without it being stayed or struck down by any court, shall have same effect, so that the said Circular would in that case loose its binding force on the AO. Further, a decision by a non-jurisdictional High Court shall not have the same affect in-as-much as the same is not binding on the AO (refer: *Suresh Desai & Ass. v. CIT* [1998] 230 ITR 912 (Del); *Geoffery Manners & Co. Ltd. v. CIT* [1996] 221 ITR 695 (Bom); *CIT v.*

Thane Electricity Supply Ltd. [1994] 206 ITR 797 (Bom); *Patil Vijayakumar v. Union of India* [1985] 151 ITR 48 (Kar)). No such decision by either the Hon'ble jurisdictional High Court or the Hon'ble Apex Court has been brought to our notice.

The moot question therefore is if the said Circular is in conformity with the law. Section 14A, immediately succeeds section 14 – the first section of Chapter IV of the Act, enumerating the heads of income under which all income, subject to the other provisions of the Act, is to be classified for the purpose of computation of total income, introduced by Finance Act, 2001 w.r.e.f. 01.04.1962 (since renumbered as 14A (1)), reads as under:

> **'Expenditure incurred in relation to income *<u>not includible</u>* 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.'
>
> [emphasis, supplied]

The issue is if section 14A(1) would stand attracted even if such income, i.e., income not includible in the total income, is not actually earned, of course, subject to expenditure relatable to such income having been incurred. The Circular 5/2014, after explaining the rationale of the provision of section 14A (with reference to Circular 14 of 2001), i.e., to curb the practice of reducing the tax liability on taxable income (i.e., income forming part of the total income) by claiming expenditure incurred in earning tax-exempt income against taxable income, goes on to state that the legislative intent is that the expenditure *relatable to earning such income* shall have to be considered for disallowance. Surely, in that event i.e., expenditure relating to earning tax-exempt income having been incurred, it would become irrelevant if the exempt income has actually materialized or not, so that the disallowance of the said expenditure u/s. 14A would ensue. The same therefore is only a continuation of Circular 14 of 2001, taking the premise of section 14A to its logical conclusion. And which is to apply the basic principle of taxation, i.e., that it is only the net income - taxable or non-taxable, i.e., net of all expenditure incurred for earning the same, that could be subject to tax or, as the case may be, exempt from tax. The latter Circular, which is again in consonance with the Memorandum explaining the provisions of Finance Bill, 2001 (introducing section 14A) as well as the Notes to the Clauses presented along with the said Bill, has been noted with approval by the Hon'ble Apex Court in *CIT v. Walfort Share & Stock Brokers P. Ltd*. [2010] 326 ITR 1 (SC), holding as under: (pgs. 15-16)

'The insertion of section 14A with retrospective effect is the serious attempt on the part of Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act against the taxable income (see Circular No. 14 of 2001 dated November 22, 2001). *In other words, section 14A clarifies that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income*. In many cases the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of section 14A, the expenditure incurred in respect of exempt income was being claimed against taxable income. The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail of the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The basic reason for insertion of section 14A is that certain incomes are not includible while computing total income as these are exempt under certain provisions of the Act.'

The issue, thus, considered in perspective, is not if the income not forming the part of the total income (the tax-exempt income) is earned or not, but if expenditure relatable to such income has been incurred. If such expenditure stands incurred, section 14A(1) becomes applicable. With regard to the scope of the relatable expenditure, the Apex Court clarified the same with reference to any expenditure enumerated in sections 15 to 59 (para 17, pgs. 16-17 of the Reports). The question is simple. If taxable income (i.e., income forming part of the total income) is to be added at net of relatable expenditure, how could it be otherwise for the tax-exempt income? Rather, if not so considered, not only would it violate the basic principle of taxation, it would defeat the very purpose of section 14A, as expenditure relatable to tax-exempt income, where not earned, would get charged against taxable income. The actual earning of income - taxable or not taxable, as is apparent, and as we shall presently see, is irrelevant for the admissibility of such expenditure against the relevant income.

The afore-referred decision by the Apex Court stands followed and explained at length in *Godrej & Boyce Mfg. Co. Ltd. v. Dy. CIT* [2010] 328 ITR 81 (Bom), culling out the principles laid down therein, as under: (para 31, pgs. 98-99)

'31. The following principles would emerge from s. 14A and the decision in *Walfort* (supra):

(a) The mandate of s. 14A is to prevent claims for deduction of expenditure in relation to income which does not form part of the total income of the assessee;

(b) Sec. 14A(1) is enacted to ensure that only *expenses incurred in respect of earning taxable income are allowed*;

(c) The principle of apportionment of expenses is widened by s. 14A to include even the apportionment of expenditure between taxable and non-taxable income of an indivisible business;

(d) The basic principle of taxation is to tax net income. This principle applies even for the purposes of s. 14A and expenses *towards* non-taxable income must be excluded;

(e) Once a proximate cause for disallowance is established - which is the relationship of the expenditure with income which does not form part of the total income - a disallowance has to be effected. All expenditure incurred *in relation to* *income* which does not form part of the total income under the provisions of the Act has to be disallowed under s. 14A. Income which does not form part of the total income is broadly adverted to as exempt income as an abbreviated appellation.'

(emphasis, ours)

Continuing further, with specific reference to the apportionment of expenditure in relation to the income not forming part of the total income, it would be relevant to reproduce from the extracted part of the decision in *Walfort Share & Stock Brokers P. Ltd.* (supra), as under, to which decision abundant reference stands made by the Hon'ble Court: (para 51, pgs. 106-107)

'51. We have also been fortified in the conclusion which we have drawn, by the judgment of the Supreme Court in *Walfort* (supra). The Supreme Court has in the following observation expressly held that since dividend income does not form part of the total income, the expenditure that is *incurred in the earning of such income* cannot be allowed even though it is of a nature specified in ss. 15 to 59 :

"If an income like dividend income is not a part of the total income, the expenditure/deduction though *of the nature specified in ss. 15 to 59* but related to the income not forming part of the total income could not be allowed against other income includible in the total income for the purpose of chargeability to tax."

Having observed thus, the Supreme Court held that the theory apportioning expenditure between taxable and non-taxable income has now, in principle, been widened under s. 14A. Hence, for the reasons that we have indicated earlier, we hold that income from dividend on shares is, in the hands of the recipient shareholder, income which does not form part of the total income. Hence, s. 14A would apply and the *expenditure incurred in earning such income* would have to be disallowed. Income from mutual fund stands on the same footing.'

(emphasis, ours)

Continuing our discussion, how, one may ask, could the expenditure incurred in earning tax-exempt income stand altered, either in nature or in quantum, depending on the quantum of the tax-exempt income, which could therefore be nil. The expenditure is incurred to produce or generate or in anticipation of, income, whether taxable or non-taxable. In fact, the classification as to tax status (i.e., taxable or non-taxable) has nothing to do with the income generating process; an income being, as a matter of fiscal incentive, being granted tax-exempt status, viz. agricultural income, under the Act, for the time being. An income exempt as per the extant law may not be so earlier or in fact even in future; the law witnessing a variation in this respect from time to time. The quantum of income that may arise is however, largely, uncertain, and which may be higher or lower (including nil) than the volume of the expenditure incurred. It is the latter case which results in the phenomenon of 'loss', which could thus be across both the categories of income, i.e., tax-exempt and taxable. The fact of the having incurred expenditure for earning income – tax-exempt (or non-exempt), which is largely a question of fact, would thus remain, and not undergo any change, irrespective of whether it has resulted in any income (of either genre), or in a sum lower than the expenditure incurred toward the same. The principle is well-settled, representing a fundamental concept of taxation, i.e., the allowability (or otherwise) of an expenditure would not depend upon whether it has in fact resulted in an income, i.e., positive income, which is in any case a matter subsequent, and that the mere fact that expenditure stands incurred for the purpose is sufficient for its admissibility, explained by the Apex Court in *CIT v. Rajendra Prasad Mody* [1978] 115 ITR 519 (SC). The Apex Court was in that case examining the true interpretation of section 57(iii), which employed the words 'any expenditure (not being in the nature of capital expenditure) laid out or expended for the purpose of making or earning such income', the question of law raised before it reading as under:

> "*Whether, on the facts and in the circumstances of the case, interest on money borrowed for investment in shares which had not yielded any dividend is admissible under s. 57(iii)*?"

The Revenue's contention was that the words of s. 57(iii) being narrower, contrasting them with the language of section 37(1), which allowed any expenditure laid out or expended wholly and exclusively for the purpose of business or profession in computing business income, the making or earning of income was a *sine qua non* to the admissibility of the expenditure u/s. 57(iii). *And, therefore, where no income resulted, no expenditure would be deductible*. The Apex Court, after a review of the judicial precedents, which it cited with abundance, also reproducing there-from, rejected the Revenue's contention, stating that the plain and natural construction of the *language of s. 57(iii) irresistibly leads to the conclusion that to bring a case within the section, it is not necessary that any income should in fact have been earned as a result of the expenditure* (pg. 522 of the Reports). Any other interpretation, to our mind, would not meet the test of equity and be liable to be regarded as arbitrary. The Apex Court in fact pointed out to the oddity of the situation arising out of the Revenue's argument, giving an example (at page 522-523 of the Reports) where an expenditure of Rs.1,000/- (say) would not be deductible if no income was earned, while would get allowed even if Re. 1 was earned, resulting in a loss of Rs.999 under the head "Income from other sources". This is also – inasmuch as the expenditure has not resulted in any dividend income, the assessee's argument or claim in the instant case and, thus, liable to be ousted with equal force, even as the words employed in section 57(iii) – which in any case had to be heeded to, were indeed narrower than the scope of the words employed in section 14A, and which have been interpreted by the Hon'ble Courts as implying any expenditure, direct or indirect, which has a proximate nexus with or is attributable to the income under reference. Going by the example of the present case, if interest expenditure is incurred for acquiring and holding the shares, it would be so - a matter of fact, and it would matter little whether dividend income, or in whatever sum, stands earned. If it stands incurred, it is so, even if and irrespective that no dividend thereon has been declared and, thus, earned. This may be despite the relevant company having earned adequate profits to be able to declare dividend, being essentially a matter of business policy and prerogative of the Management. Expenditure by way of interest has, in either case, i.e., the dividend being declared or not, *been incurred in earning that income*, that is, in relation to that income and, therefore, would require being determined and excluded, being in relation to income not forming a part of the total income. As afore-noted, this aspect stands amply explained in *Rajendra Prasad Mody* (supra), pointing to the oddity that arises when expenditure is recognized only when it produces a positive gross income. One may pause here to note that interest shall fall either u/s. 36(1)(iii) or u/s. 57(iii), i.e., fall within sections 15 to 59, where the income under reference (viz. dividend income) was to be considered as otherwise assessable as either 'business income' or as 'income from other sources'. The principle informing the legislation of section 14A, or its insertion on the statute-book, which the Circulars by the Board have sought to explain and impress upon, stands upheld by the Hon'ble Apex Court as well as by the Hon'ble Courts, explaining and following its' decision, also upholding the constitutionality of r. 8D, prescribing the method and procedure for apportionment of expenses. The principle, i.e., of only the net income being liable to tax and, therefore, the income which is not liable to tax - is well-settled, and in fact basic to the taxing statutes for the taxing of income, *and does not admit of two views*. This also explains it being made applicable w.r.e.f. 01/4/1962, i.e., from the date the Act itself comes into effect. Section 14A, as may now be clear, is toward providing the legislative framework for operationalizing the said principle by way of apportionment of the relevant expenditure, i.e., between taxable or non-taxable income/s, which assumes particular significance where incurred for an undivisible business. Why, direct expenditure in relation to tax-exempt income, as agriculture income (say), would get excluded for being allowed as deduction in computing taxable income even in the absence of section 14A, i.e., on the basis of principle of net income, i.e., net of expenditure incurred in relation to such income, as liable to tax (or to be excluded in computing the taxable income), as explained by the Tribunal in per its decision in *ITO v. Daga Capital Management Pvt. Ltd.* [2009] 312 ITR (AT) 1 (Mum) (SB); *Damani Estates & Finance (P.) Ltd.* [2013] 25 ITR (Trib) 683 (Mum); *D. H. Securities (P.) Ltd. v. Dy. CIT* [2013] 31 ITR (Trib) 381 (Mum), to cite some. How could, one may ask, the agriculture expenditure incurred for agricultural activity, be claimed or allowed against taxable (as, say, business) income. This is as there is no question of apportionment of such expenditure, which arises only in the case of indirect expenditure, which could be either interest or any other, viz. administrative expenditure.

Reference in this regard may finally be made to the recent decision by the Hon'ble Apex Court in *Maxopp Investment Ltd. & Ors. v. CIT* (in CA Nos. 104-109 of 2015, dated February 12, 2018 / copy on record). For our purposes, para 3 of the Judgment is of prime relevance, and which we reproduce as under:

'3. Though, it is clear from the plain language of the aforesaid provision that no deduction is to be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under the Act, the effect whereof is that if certain income is earned which is not to be included while computing total income, any expenditure incurred to earn that income is also not allowed as a deduction. It is well known that tax is leviable on the net income. *Net income is arrived at after deducting the expenditure incurred in earning that income*. Therefore, from the gross income, *expenditure incurred to earn that income* is allowed as a deduction and thereafter tax is levied on the net income. The purpose behind Section 14A of the Act, by not permitting deduction of the expenditure incurred in relation to income, which does not form part of total income, is to ensure that the assessee does not get double benefit. Once a particular income itself is not to be included in the total income and is exempted from tax, *there is no reasonable basis for giving benefit of deduction of the expenditure incurred in earning such an income*. For example, income in the form of dividend earned on shares held in a company is not taxable. If a person takes interest bearing loan from the Bank and invests that loan in shares/stocks, dividend earned therefrom is not taxable. Normally, interest paid on the loan would be expenditure incurred for earning dividend income. Such an interest would not be allowed as deduction as it is an expenditure incurred in relation to dividend income which itself is spared from tax net. *There is no quarrel upto this extent*.' (emphasis, ours)

The principle behind section 14A and its applicability, and toward which the Hon'ble Court cites an example - which is the same as that obtains in the present case, is so well established that the Apex Court itself finds the same as settled and not disputed. The applicability of sec. 14A does not hinge on the actual earning of the tax-exempt income. Reference for the purpose may be made to the majority of view in *Daga Capital Management Pvt. Ltd.* (supra) (at para 8 of the Judgment), noted with the approval by Hon'ble Apex Court, as well as the arguments made before the Hon'ble High Court, pleading that the actual earning of dividend income was immaterial in-as-much as the relatable expenditure would remain the same (at para 30 of the Judgment), and which the Hon'ble Court found as so, noting that it would be earned by a quirk of fate where shares are held as 'stock-in-trade', while would stand to be earned whenever dividend is declared on shares held as investment - as in the present case, as in either case, section 14A gets attracted (para 40). The dispute in that case was with regard to the scope of the words 'in relation thereto' occurring in section 14A(1) as well as the relevance of the object for which the investment yielding (or liable to yield) tax-exempt income is made, on which there was variance between different High Courts. The words 'in relation thereto' were clarified to be accorded an expansive meaning so as to sub-serve the legislative intent behind sec. 14A, and the theory of predominant object had no place in the scheme of s. 14A.

5. *In sum*

The principle that it is the net income, i.e., net of expenditure relatable thereto, which is subject to tax and, correspondingly, not liable to tax, i.e., where it does not form part of the total income, is well established. Equally well settled is the principle that once an income is liable (or not liable) to tax, all expenditure relatable thereto is to be reckoned, and it matters little that the said expenditure has indeed resulted in a positive income, or in whatever sum. It is in fact this, i.e., the expenditure being higher than the gross income, which could be nil, that leads to the phenomenon of loss, which could therefore be across both the categories income, i.e., taxable or non-taxable, being essentially a matter of fact. The interpretation of the words 'for earning such income' stands already settled by the Apex Court in *Rajendra Prasad Mody* (supra). To therefore recognize relatable expenditure where it fructifies in a positive income is misconceived. It is, it may be appreciated, the quality of the expenditure that determines its deductibility and not its quantum or effect, i.e., where it stands incurred for the stated purpose. Given the premise of section 14A, i.e., to exclude income not forming part of the total income in computing the 'total income', with a view to determine the latter correctly, and the two principles afore-referred, the proposition under reference, i.e., to exclude all expenditure relatable to the earning of income not forming part of the total income, irrespective of its quantum, becomes axiomatic, even as noted by the Hon'ble Apex Court in *Maxopp Investment Ltd*. (supra). Para 32 thereof reads as under:

'32. In the first instance, it needs to be recognized that as per section 14A(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 (not) 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.'

Where, one wonders, then, is the scope for two views. Relying extensively on its decision in *Walfort Share & Stock Brokers P. Ltd.* (supra), the Apex Court upheld the theory of apportionment, discountenancing the theory of predominant object. The uncertainty of earning the dividend income, or of it being earned incidentally, was also noted by it, though to no moment. It was immaterial if dividend income was actually earned or not, which, rather, may be a consideration where the shares, as in the present case, are held to retain control over the investee company, i.e., for strategic reasons, as was the case with regard to the investment by *Maxopp Investment Ltd.* – one of the assessees in that case. The related expenditure has to be reckoned on an expansive basis, i.e., as attributable thereto. The constitutionality of r.8D, providing for rules of apportionment of both direct and indirect expenditure, stands already upheld by the Hon'ble High Court in *Godrej & Boyce Mfg. Co. Ltd.* (supra). Earlier, in *Godrej & Boyce Mfg. Co. Ltd. v. Dy. CIT* [2017] 394 ITR 449 (SC), with reference to the language of section 14A, the title of which is itself clarificatory, the Apex Court clarified that income must not be includible in the total income, so that once this *condition* is satisfied, the expenditure incurred in earning the same cannot be allowed to be deducted. The AO in the present case has clearly failed to apply the law in the matter, which gets reiterated time and again by the Hon'ble Apex Court.

Decision

6. In view of the foregoing, we find no merit in the assessee's case. We, accordingly, uphold the impugned order, both on the aspect of lack of inquiry by the assessing authority, as well as his non-observance of the Board Circular

5/2014, which we have found to be in consonance with the law as explained by the Apex Court. The impugned order being after the date of amendment (by way of *Explanation 2*) to section 263, i.e., 01.06.2015, the same is an equally valid ground for the exercise of revisionary power u/s. 263. It is this power, i.e., to deem an order as erroneous in-so-for as it is prejudicial to the interests of the Revenue, that stands conferred w.e.f. 01.06.2015. That is, the law, w.e.f. 01.06.2015, deems an order as so, where any of the circumstances specified is, in the opinion of the competent authority, satisfied. It has nothing to do with the date of the passing of the order deemed erroneous, or the year to which it pertains. Being a part of the procedural law, the provision shall have effect from 01/06/2015 (also refer *CWT v. Sharvan Kumar Swarup & Sons* [1994] 210 ITR 886 (SC)). Rather, as we find on a perusal of the cited decisions by the Apex Court settling the law in the matter, the assessment does not represent a correct application of the law, furnishing one more ground, albeit *pari materia*, for the assessment being liable for revision u/s. 263. We decide accordingly.

7. In the result, the assessee's appeal is dismissed.

Order pronounced in the open court on 12 .04.2018

Sd/-
(N. K. Choudhry)
Judicial Member

Sd/-
(Sanjay Arora)
Accountant Member

Dated: 12.04.2018
/GP/Sr. Ps.

Copy of the order forwarded to:

(1) The Assessee: Lally Motors India P. Ltd., Jalandhar
(2) The Pr.CIT-2, Jalandhar
(3) The CIT-2, Jalandhar
(4) The CIT, concerned
(5) The Sr. DR, I.T.A.T.

True copy

By Order