(2016) 09 P&H CK 0172

In the Punjab And Haryana At Chandigarh

Case No : Income Tax Appeal No. 186 of 2013 (O&M)

Commissioner of Income Tax APPELLANT

Vs

M/s Max India Limited RESPONDENT

Date of Decision : 06-09-2016

Acts Referred:
Income Tax Act, 1961 — Section 14A

Citation : (2016) 290 CurTR 76 : (2016) 388 ITR 81

Hon'ble Judges : Mr. S.J. Vazifdar, CJ. and Mr. Deepak Sibal, J.

Bench : Division Bench

Advocate : Mr. Vivek Sethi, Advocate, for the Appellant; Mr. Ajay Vohra, Senior Advocate with Mr. Gaurav Jain, Advocate, for the Respondent

Final Decision : Dismissed

Judgement

,,,,

S.J. Vazifdar, C.J.—This is an appeal against the order of the Tribunal allowing the assessee''s appeal by deleting the disallowance made by the",,,,

Assessing Officer. The matter pertains to the assessment year 2002-03. The Tribunal''s order was passed also in ITA No.119 (Asr)/2011 which is,,,,

the matter relevant to this appeal.,,,,

2. The following substantial questions of law arise in this appeal:-,,,,

(i) Whether on the facts of the case and in law the Hon''ble ITAT was justified in holding that no expense is attributable to the exempted income",,,,

as the revenue had failed to establish a direct nexus between the expenses incurred and the income earned ignoring that even indirect expenses are,,,,

attributable u/s 14A as has been made clear by providing for Rule 8D(2) in subsequent assessment years?,,,,

(ii) Whether on the facts of the case the ITAT is right in holding that the legal and professional expenses are allowable ignoring the fact that the,,,,

assessee has failed to discharge its onus with respect to rendering of services by the payee?""",,,,

3. The assessee are engaged in various activities which they carry on through their different divisions, such as, the packaging, metallise, max foil,",,,,

pharma, treasury and health care divisions.",,,,

4. The assessees filed a return declaring a ''nil'' total income under the normal provisions with a brought forward loss and Rs. 6,80,27,490/-",,,,

computed under section 115JB of the Income Tax Act, 1961. A revised return in the same terms was filed except to declare a short term capital",,,,

gain arising from the sale of one of the divisions. The matter was taken up for scrutiny and a questionnaire was addressed to the assessee.,,,,

Re: Question (i),,,,

5. During the previous year relevant to assessment year 2002-03, the assessee admittedly earned exempted income by way of interest of which",,,,

Rs.55 lakhs was interest on Maharashtra State Electricity Bonds and Rs. 2,91,97,852/- was earned by way of dividends. The aggregate amount",,,,

of Rs. 3,46,97,852/- was deducted by the assessee being exempted under the Act. The question is whether there was any expenditure relatable to",,,,

the exempted income for, if there was, the provisions of Section 14A of the Act would apply. Section 14A reads as under:-",,,,

14-A. Expenditure incurred in relation to income not includible in total income.-(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.,,,,

(2) The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total,,,,

income under this Act in accordance with such method as may be prescribed, if the Assessing Officer, having regard to the accounts of the",,,,

assessee, is not satisfied with the correctness of the claim of the assessee in respect of such expenditure in relation to income which does not form",,,,

part of the total income under this Act.,,,,

(3) The provisions of sub-section (2) shall also apply in relation to a case where

an assessee claims that no expenditure has been incurred by him in,,,,

relation to income which does not form part of the total income under this Act.,,,,

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under Section 147 or pass an order,,,,

enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under Section 154, for any",,,,

assessment year beginning on or before the 1st day of April, 2001.""",,,,

6. The Assessing Officer rejected the assessee''s contention that it had not incurred any expenditure for the purpose of earning the exempt income,,,,

observing that the possibility of the assessee having incurred expenditure relatable to such exempt income could not be ruled out. The Assessing,,,,

Officer held that on identical facts for the Assessment Year 2001-02, ad hoc disallowance relatable to such expenditure incurred for the purpose",,,,

of earning exempt income was made and on the same basis he made a disallowance of Rs. 1.5 crores under Section 14A. The assessee contended,,,,

that the investment had been made out of its own funds and not from the borrowed funds and, therefore, disallowance was not called for; that the",,,,

dividend was received as long term investment during the relevant previous year and that no expenditure was attributable towards earning the same,,,,

as the dividend received was only incidental to the holding of shares; that the dividend was received by single dividend warrants, and therefore, no",,,,

expenditure was incurred to earn such dividend; that the assessee had not claimed any expenditure in relation to income which did not form part of,,,,

the total income; that there was no nexus between the dividend expenditure and the expenses which were sought to be deducted and that the,,,,

revenue had failed to establish any nexus between the expenditure and the exempt income.,,,,

7. The CIT (Appeals) not only upheld the Assessing Officer''s order of disallowance but enhanced the same to about Rs. 4.33 crores. The CIT,,,,

(Appeals), however, noted as had the Assessing Officer that the assessee had failed to produce the bank statements though called upon to do so.",,,,

The assessee on the other hand expressed its inability to produce the bank statements in respect of the utilisation of the borrowed funds or to show,,,,

the sources of funds for the investment made on the ground that the bank statements related to an ï¿½old period'' and that it was difficult, therefore,",,,, to produce the same. The assessment order under Section 143(3) was passed on 30.03.2004 and the order of the CIT (Appeals) is dated,,,,

19.01.2006. The same pertain to the assessment year 2002-03. The assessee, however, further contended that the positive cash flow and surplus",,,,

interest free funds available with the assessee during the relevant previous year were sufficient to cover the said interest free investment. The,,,,

presumption, it was contended, is that the said investments were made from the assesses interest free reserves and, therefore, it was for the",,,,

department to rebut the presumption by establishing the nexus between the funds borrowed on investment and the said investment. The CIT,,,,

(Appeals) drew an adverse inference which was one of the main reasons for the order passed by the CIT (Appeals). The assessee also relied,,,,

upon the agreements it had entered into with various lenders to establish that the funds borrowed on interest were utilised for purposes other than,,,,

the said investment. The CIT (Appeals) analysed each of the documents. It was observed that in the absence of the bank books and bank,,,,

,,01-04-01,01-04-02,Average

Shareholders'' (Rs. 000),A,5255753,5173108,5214431

Loan funds (Rs. 000),B,1291595,1867238,1579417

Ratio of borrowed funds to

total funds","C=Average

A/(Avg.A+

Avg.B)",,,0.23

Relaxation in ratio by 50%,D=0.5*C,,,0.12

,,,,

,,,,

Interest expenditure (Rs.

000)",E,,,154928

Average cost of funds,"F=E/Average of

B",,,9.81%

Specified investments(Rs.),G,3107576219,4486634216,3797105218

Investment of borrowed

funds in Specified

Investments (Rs.)",H=D*G,,,441370746

Interest expenditure on

borrowed funds invested in

Specified Investments (Rs.)",I=H*F,,,43294905

3. Mr. Dipak Bhattacharyya, learned counsel appearing for the appellant, argued with vehemence that the assessee having deposited the entire",,,,

profits in the overdraft account and the amount thus deposited in the overdraft account being much more compared to the income tax liability and,,,,

the tax paid, it should have been presumed that in essence and true character the taxes were paid out of the profits of the relevant year and not out",,,,

of the overdraft account for the running of the business. Consequently the interest paid by the assessee on the overdraft account relatable to the,,,,

payment of income tax should have been allowed as an admissible deduction in the computation of the assessee''s business income. In support of,,,,

this contention the learned counsel appearing for the appellant relied upon the decisions of the Calcutta High Court in Woolcombers of India Ltd.,,,,

v. CIT[(1982) 134 ITR 219 : (1981) 23 CTR 204 (Cal)], Reckitt and Coleman of India Ltd.v. CIT (1982) 135 ITR 698 : (1982) 26",,,,

CTR 24 (Cal), Indian Explosives Ltd. v. CIT[(1984) 147 ITR 392 : 1983 Tax LR 356 (Cal) and Alkali & Chemical Corpn. of India",,,,

Ltd. v. CIT (1986) 161 ITR 820 (Cal). The learned counsel also urged that these decisions having been allowed to be operative for more than,,,,

14 years, the principle of stare decisis should be made applicable and, therefore, it must be held that the High Court committed error in not",,,,

accepting the assessee''s contention......,,,,

4. Having considered the rival submissions at the Bar though we find considerable force in the arguments advanced by the learned counsel,,,,

appearing for the appellant but in the facts and circumstances of the present case, on going through the order of the Tribunal as well as the question",,,,

referred to by the Tribunal for being answered by the High Court and the arguments advanced before the Tribunal as well as in the High Court by,,,,

the counsel appearing for the assessee, it is not possible for us to hold that any such contention, as was advanced before this Court by the assessee",,,, had in fact been advanced either before the Tribunal or before the High Court. The question whether a presumption can be drawn that the taxes,,,,

were paid out of the profits of the relevant year and not out of the overdraft account for the running of the business as was drawn in Woolcombers,,,,

case (1982) 134 ITR 219 : (1981) 23 CTR 204 (Cal) by the Calcutta High Court and was followed in 3 other cases of the same High Court,",,,,

would essentially depend upon the fact as to whether the entire profits had been pumped into the overdraft account, whether such profits were",,,,

more than the tax amount paid for the relevant year and all other germane factors. But when the assessee never advanced the contention either,,,,

before the Tribunal or before the High Court and the amplitude of the question posed before the High Court does not bring within its sweep the,,,,

contention as is advanced by Mr. Bhattacharyya, learned counsel in this Court, it would not be appropriate for this Court to look into the",,,,

additional papers produced by the assessee for entertaining the contention and answering the same. It is true that the Calcutta High Court in,,,,

Woolcombers case (1982) 134 ITR 219 : (1981) 23 CTR 204 (Cal) came to the conclusion that where profits were sufficient to meet the,,,,

advance tax liability and profits were deposited into the overdraft account of the assessee then it should be presumed that the taxes were paid out,,,,

of the profits of the year and not out of the overdraft account for the running of the business. But to raise the presumption in that particular case,,,,

there were sufficient materials and the assessee had urged the contention before the High Court. The aforesaid decision has been followed in the,,,,

case of Reckitt (1982) 135 ITR 698 : (1982) 26 CTR 24 (Cal) where without any further discussion the Woolcombers case (1982) 134 ITR,,,,

219 : (1981) 23 CTR 204 (Cal) has been followed. But it may be noticed that the question posed in Reckitt case (1982) 135 ITR 698 :,,,,

(1982) 26 CTR 24 (Cal) was directly to the effect as to where the entire trading receipts deposited by the assessee in the overdraft account and,,,,

the tax was paid out of the overdraft account whether the interest paid by the assessee for payment of tax out of the overdraft account is an,,,,

allowable deduction. In Indian Explosives Ltd. case (1984) 147 ITR 392 : 1983 Tax LR 356 (Cal) the aforesaid two decisions of the,,,,

Calcutta High Court had been followed and the question that had been posed was to the effect whether the interest on an overdraft account paid,,,, towards the amount drawn for discharging the tax liability could be an allowable expenditure and, therefore, the High Court answered in favour of",,,,

the assessee and against the Revenue. It may be noticed that in the aforesaid case the Court did not express any opinion on the question whether,,,,

the interest paid on money borrowed for payment of tax was allowable as business expenditure. To the same effect is the decision of the Calcutta,,,,

High Court in Alkali Chemical Corpn. of India Ltd. (1986) 161 ITR 820 (Cal),,,,

(emphasis supplied)""",,,,

16. It may be said that this was a case where the funds were all in a common pool viz. in the overdraft account. It would, however, make no",,,,

difference even if the funds are in different accounts. The presumption would still apply so long as the interest free funds are available. Our view is,,,,

supported by the judgment of a Division Bench of the Bombay High Court in Commissioner of Income Tax v. Reliance Utilities and Power,,,,

Ltd. 2009(313) ITR (Bombay), where it was held:-",,,,

If there be interest-free funds available to an assessee sufficient to meet its investments and at the same time the assessee had raised a loan it can",,,,

be presumed that the investments were from the interest free funds available. In our opinion, the Supreme Court in East India Pharmaceutical",,,,

Works Ltd. v. CIT, [1997] 224 ITR 627 had the occasion to consider the decision of the Calcutta High Court in Woolcombers of India Ltd.,",,,,

[1982] 134 ITR 219 where a similar issue had arisen. Before the Supreme Court it was argued that it should have been presumed that in essence,,,,

and true character the taxes were paid out of the profits of the relevant year and not out of the overdraft account for the running of the business and,,,,

in these circumstances the appellant was entitled to claim the deductions. The Supreme Court noted that the argument had considerable force, but",,,,

considering the fact that the contention had not been advanced earlier it did not require to be answered. It then noted that in Woolcombers of,,,,

India Ltd.''s case, [1982] 134 ITR 219 the Calcutta High Court had come to the conclusion that the profits were sufficient to meet the advance",,,,

tax liability and the profits were deposited in the over draft account of the assessee and in such a case it should be presumed that the taxes were,,,,

paid out of the profits of the year and not out of the overdraft account for the running of the business. It noted that to raise the presumption, there",,,, was sufficient material and the assessee had urged the contention before the High Court. The principle, therefore, would be that if there are funds",,,,

available both interest-free and over draft and/or loans taken, then a presumption would arise that investments would be out of the interest-free",,,,

fund generated or available with the company, if the interest-free funds were sufficient to meet the investments. In this case this presumption is",,,,

established considering the finding of fact both by the Commissioner of Income-tax (Appeals) and the Income-tax Appellate Tribunal.""",,,,

We are in respectful agreement with these observations. There is no reason to restrict the presumption to cases where the funds from different,,,,

sources are mixed in a common pool. The rational for the presumption is that an assessee would utilise its funds prudently ensuring that it derives,,,,

the greatest financial advantage. If that be the rational we see no reason for the presumption to be restricted to cases where the different funds are,,,,

mixed in a common pool. It is, however, only a presumption.",,,,

17. In HDFC Bank Ltd. v. Deputy Commissioner of Income Tax and others, 2016 (383) ITR 529 (Bombay), the petitioner filed its return",,,,

of income for the assessment year 2008-09 in which it declared an income of Rs. 5.81 crores from the investment and securities which were,,,,

exempt from tax. It treated these investments as stock in trade. The petitioner had during that year paid interest on borrowed funds and claimed the,,,,

same as expenditure. The petitioner claimed that the investment in tax free securities was made out of its own tax free funds and therefore no,,,,

disallowance could be made under section 14A. The petitioner contended that it was possessed of sufficient interest free funds of Rs. 2153 crores,,,,

as against the investment in tax free securities of Rs. 52.02 crores and that there was a presumption that the investment which had been made in the,,,,

tax-free securities had come out of the interest-free funds available with the petitioner. The Division Bench held:-,,,,

15. It is clear that for the first time in the case of HDFC Bank Ltd. (supra) that this Court took a view that the presumption which has been laid",,,,

down in Reliance Utilities and Power Ltd. (supra) with regard to investment in tax free securities coming out of assessee''s own funds in case the,,,,

same are in excess of the investments made in the securities (notwithstanding fact that assessee concerned may also have taken some funds on,,,, interest) applies, when applying Section 14A of Act. Thus, decision of this Court in HDFC Bank Ltd. (supra) for the first time on 23rd July, 2014",,,,

has settled the issue by holding that the test of presumption as held by this Court in Reliance Utilities and Power Ltd. (supra) while considering,,,,

Section 36(1)(iii) of the Act would apply while considering the application of Section 14A of the Act. The aforesaid decision of this Court in,,,,

HDFC Bank Ltd. (supra) on the above issue has also been accepted by the Revenue inasmuch as even though they have filed an appeal to the,,,,

Supreme Court against that order on the other issue therein viz. broken period interest, no appeal has been preferred by the Revenue on the issue",,,,

of invoking the principles laid down in Reliance Utilities and Power Ltd. (supra) in its application to Section 14A of the Act. Therefore, the issue",,,,

which arose for consideration before the Tribunal had not been decided by this Court in Godrej and Boyce Manufacturing Co. Ltd. (supra). It,,,,

arose and was so decided for the first time by this Court in HDFC Bank Ltd. (supra). Thus, there is no conflict as sought to be made out by the",,,,

impugned order. Thus, the impugned order has proceeded on a fundamentally erroneous basis as the ratio decindi of the order in Godrej and",,,,

Boyce Manufacturing Co. Ltd. (supra) had nothing to do with the test of presumption canvassed by the petitioner before the Tribunal on the basis,,,,

of the ratio of the decision of this Court in HDFC Bank Ltd. (supra).,,,,

16. At the hearing Mr. Suresh Kumar, learned Counsel for the Revenue urged that on the facts of this case no fault can be found with the order of",,,,

the Tribunal. It is submitted that, the petitioner was not able to establish before the Assessing Officer and the CIT(A) that the amounts invested in",,,,

the interest free securities came out of interest free funds available with the petitioner. In that view of the matter, it is submitted by him that the order",,,,

of this Court in HDFC Bank Ltd. (supra) would not apply to the facts of the present case. We are unable to understand the above submission. The,,,,

Assessing Officer passed the Assessment order on 22nd December, 2010 under Section 143(3) of the Act. The CIT (A) passed an order on 21st",,,,

November, 2011 dismissing the petitioner''s appeal. On both the dates, when the orders were passed by the Assessing Officer and CIT (A), the",,,,

authorities did not have the benefit of the order of this Court in HDFC Bank Ltd. (supra) rendered on 23rd July, 2014. Once the issue is settled by",,,, the decision of this Court in HDFC Bank Ltd. (supra), there is now no need for the assessee to establish with evidence that the amounts which has",,,,

been invested in the tax free securities have come out of interest free funds available with it. This is because once the assessee is possessed of,,,,

interest free funds sufficient to make the investment in tax free securities, it is presumed that it has been paid for out of the interest free funds.",,,,

Consequently, we do not find any merit in the above submission made at the hearing on behalf of the Revenue.",,,,

(emphasis supplied)""",,,,

We respectfully agree with these observations. While it is only a presumption, it is one which is in the assessee''s favour. The Department could",,,,

have rebutted this presumption by calling for the records from the bank itself. It chose not do so at though the assessee stated that it was not in,,,,

possession of the records. There was no application either before the Tribunal or before us for an opportunity to lead further evidence in this,,,,

regard.,,,,

18. A similar view was taken by the Bombay High Court in Commissioner of Income Tax v. HDFC Bank Ltd. 2014 (366) ITR 505.,,,,

19. A Division Bench of this Court in Bright Enterprises Pvt. Ltd. v. Commissioner of Income Tax 2016 (381) ITR 107, to which one of us",,,,

(S.J. Vazifdar, C.J.) was a party, followed the judgment in CIT v. Reliance Utilities and Power Ltd. 2009 (313) ITR (Bombay) (supra). It",,,,

was held as follows:-,,,,

23. As we noted earlier, the funds/reserves of the appellant were sufficient to cover the interest free advances made by it of Rs. 10.29 crores to",,,,

its sister company. We are entirely in agreement with the judgment of the Bombay High Court in Commissioner of Income Tax v. Reliance,,,,

Utilities & Power Ltd., (2009) 313 ITR 340, para-10, that if there are interest free funds available a presumption would arise that investment",,,,

would be out of the interest free funds generated or available with the company if the interest free funds were sufficient to meet the investment.""",,,,

20. In the circumstances, question No.(i) is answered in favour of the respondent-assessee.",,,,

Re : Question No. (ii),,,,

21. The issue in this regard raises essentially a question of fact and not one of

law. It required the authorities to appreciate the facts and to take a,,,,

decision on the basis of balance of probabilities.,,,,

22. According to the assessee it incurred expenditure of about Rs. 1.25 crores towards legal and professional charges paid to M/s Max UK Ltd.,,,,

M/s Max UK Ltd. admittedly is the assessee''s associated enterprise. The audit report under section 92E was filed along with the return of income.,,,,

The assessee and M/s Max UK Ltd. entered into an agreement dated 01.07.1999. The relevant provisions thereof as set out in the assessment,,,,

order read as under:-,,,,

Max UK has agreed to provide the services set forth hereunder:-",,,,

(a) explore business opportunities initially in the field of Health Care, Financial Services, Life Insurance, Information Technology and allied areas;",,,,

(b) identify potential collaborations/partners desirous of entering into venture(s) in the aforesaid business areas;,,,,

(c) conduct due diligence of the potential collaborators/partners as regards its financial, management, technical capabilities and suitably for entering",,,,

into a collaboration/joint venture;,,,,

(d) information sharing and bridging of the cultural gap between the potential collaborators/partners and MAX.,,,,

(e) upon identification of a collaborator/partner and further upon completion of due diligence as aforesaid, render further assistance to MAX for",,,,

establishing contact with such potential collaborators/parties and further provide necessary interface and transactional services for,,,,

facilities/consummating the collaboration/joint venture arrangements; and,,,,

(f) other support services, as may be required, from time tome.""",,,,

23. There is some discrepancy regarding the pound sterling equivalent to the Indian rupees that were paid. This need not detain us as it not relevant,,,,

for this judgment. The parties proceeded on the basis that the amount paid was Rs. 1.25 crores and in respect of which the assessee sought a,,,,

deduction. On queries raised by the Assessing Officer, the assessee contended that it had also entered into an agreement with M/s Max UK Ltd.",,,,

for other services and that the amount of Rs. 1.25 crores was included in the legal and professional expenses of its corporate office aggregating to,,,,

about Rs. 2.12 crores. In support of his contention that the services were in fact rendered and from which the assessee benefited, the assessee",,,,

relied upon the fact that its total exports were in excess of Rs. 29 crores and that it had also benefited in the area of Health Care Services pursuant,,,,

to the notification received from M/s Max UK Ltd.,,,,

24. The Assessing Officer and the CIT (Appeals) held that the assessee had not furnished any details to establish that the services were in fact,,,,

rendered; that although the agreement provided details of the services to be provided, the assessee was unable to establish that the services were",,,,

actually provided and that there was no material to establish that M/s Max UK Ltd. was involved in any manner in obtaining export orders for the,,,,

assessee or in facilitating the exports and that particulars of the information had not been submitted.,,,,

25. The Tribunal on the other hand perceived the facts entirely differently and held in favour of the assessee. The Tribunal found that the nature of,,,,

the services rendered by M/s Max UK Ltd. was supported by an invoice. It was further found that the nature of the services provided by M/s,,,,

Max UK Ltd. were such that it was difficult to provide evidence of the services having actually been rendered. Further, the Tribunal accepted as",,,,

relevant the assessee''s contention that it was in fact able to achieve an export turnover of Rs. 29 crores and that the same demonstrated prima-,,,,

facie that the services were rendered by M/s Max UK Ltd.,,,,

26. It is not possible to say that the conclusion arrived at by the Tribunal is absurd or perverse. It is a possible view. The services such as of the,,,,

nature mentioned in the agreement between the assessee and M/s Max UK Ltd. would not necessarily be recorded in writing. Advice,",,,,

introductions, information may well be communicated orally. The possibility of this is enhanced on account of the fact that these are group",,,,

companies. Even if each of the facts by itself does not support the Tribunal''s conclusion taken together they certainly do. The Tribunal has,",,,,

therefore, taken a possible view.",,,,

27. Question No. (ii) is, therefore, also answered in favour of the assessee.",,,,

28. The appeal is, accordingly, dismissed.",,,,

