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IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "A", MUMBAI

BEFORE SHRI B. R. MITTAL, J.M. AND SHRI SANJAY ARORA, A.M.

ITA Nos. : 526 & 527/Mum/2009
Assessment Years: 2004-05 & 2005-06

Anil Kumar Nehru 5B Ananta, 762 Rajabally Patel Road, Mumbai-400 026 **[PAN NO: AAAPN 9136 G]**	Vs.	Asst. CIT, Circle 16(2), Matru Mandir, Tardeo Road, Mumbai - 400 007
(Appellant)		(Respondent)

Appellant by	:	Shri Haresh G. Buch & Shri Harsh Kapadia
Respondent by	:	Shri Manoj Kumar
Date of hearing	:	14.12.2012
Date of Pronouncement	:	26.12.2012

O R D E R

Per Sanjay Arora, AM :

This is a set of two Appeals by the Assessee, i.e., for two consecutive years, being assessment years 2004-05 and 2005-06, directed against separate Orders of even date, i.e., 15.10.2008, by the Commissioner of Income Tax (Appeals)-XVI, Mumbai ('CIT(A)' for short), disposing the assessee's appeals contesting its assessments for the relevant years vide orders u/s. 143(3) of the Income tax Act, 1961 ('the Act' hereinafter). Both the appeals raising common issues, the same were heard together, and are being disposed of vide a common, consolidated order.

2.1 These appeals were heard and disposed of by the Tribunal in the first instance vide its order dated 21/10/2011. However, as the assessee's Ground III remained to be adjudicated thereby, it, vide its order u/s. 254(2) dated 15/6/2012 (in M.A. Nos. 600 &

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601/Mum/2011 / copy on record), recalled its said order for adjudicating the said ground, which reads as under, and *qua* which alone the present appeals were heard:-

"GROUND III:

1. *The CIT(A) erred in upholding the action of the A.O. in disallowing expenses of Rs. 1,27,786/- (*) incurred on management fees on the alleged ground that these fees are for the purpose of holding of assets in Fiduciary Trust of International Account (FTI).*
2. *The Appellant prays that A.O. be directed to allow aforesaid expenses against income generated through assets held in FTI account."*

(*) Rs.2,43,375/- for the A.Y 2005-06

2.2 The facts in brief are that the assessee, in terms of an Agreement, paid the impugned sum under Fiduciary Trust of International Account (FTI) to its banker and its advisor toward management fee for his investments held in that account, which stands charged at the rate of 0.65% of the value of the portfolio managed, on an annualized basis. The Assessing Officer (A.O.) denied the assessee's claim for deduction of the same against the interest and dividend income arising on its portfolio, since the same was over and above the transaction fee charged under the FTI on buying and selling of securities, being primarily mutual fund units. That is, the activity engaged in is principally buying and selling of Units and, thus, not directly related to the earning of dividend and/or interest income and, secondly, stood separately charged for on a transaction-wise basis. The ld. CIT(A), in appeal, on the perusal of the management mandate arrived at with the International Fund Manager, found the impugned fee to be toward:

(a) safety of capital;

(b) appreciation of capital; and

(c) dividend and income earning.

As such, the management fee was paid for managing the portfolio, giving the portfolio manger the widest powers, including the power to buy and sell securities, and thereby changing the portfolio's composition, and could even, at its discretion, change

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the nature of the assets held. However, the payee is not obliged to generate any specific results, so that it may well be that despite its best efforts there is a loss for a particular year. It could not, therefore, be said that the fee was paid only for protecting the source of income. There was, accordingly, no direct nexus of the expenditure being claimed, so as to contend of it as being incurred wholly and exclusively for the purpose of earning the relevant income, being interest and dividend, as required in terms of section 57(iii) of the Act, under which the deduction was or could be claimed. He, therefore, confirmed the disallowance/s.

3. Before us, the ld. AR would submit that the entire income, including the dividend income, against which the impugned amount is being claimed as an expense, is taxable in India, being in relation to the shares of foreign company, so that s.14A has no application *qua* any part of the said expenditure being claimed. He further relied on the decisions in the case of *CIT vs. Rajendra Prasad Moody* [1978] 115 ITR 519 (SC); *CIT vs. Smt. Sushila Devi Khadaria* [2009] 183 Taxman 275 (Bom.); *Chinai & Co. (P) Ltd.* [1994] 206 ITR 616 (Bom); and *CIT vs. H.H. Maharani Shri Vijaykuverba Saheb of Morvi* [1975] 100 ITR 67 (Bom.), claiming the same to be covering the assessee's case, i.e., in principle, taking us briefly through the said orders. The ld. DR, on the other hand, relied on the orders of the authorities below, claiming that, on facts, the assessee's case is not maintainable on first principles, as expressed per the clear language of the statute, i.e., s. 57(iii) of the Act.

4. We have heard the rival contentions, and perused the material on record, including the case law cited.

4.1 The primary facts, as we gather, are largely undisputed. We may set out the scope of the services provided by the assessee's overseas banker and its advisor in relation to its portfolio, as under:

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"Services provided by overseas Banker/Advisor:

- *Deposit with any trustworthy banking institution in any country all the securities and assets which are entrusted to it.*
- *Change the nature and composition of the deposit, by selling or purchasing securities, currencies and/or precious metals.*
- *Enter into Options transactions, financial futures and forward purchases or sales of foreign exchange solely for hedging existing investments in accordance with the directives of the "Association Suisse des Banquiers".*
- *However, the Bank has no obligation to achieve specific results but will undertake actions to provide its services in the best interest of its client.*
- *Investments mandated to be in Global Balanced Account with low to medium risk through Franklin/Fiduciary Mutual Funds."*

The nature of the services availed, for which the impugned expenditure stands incurred, would need to understood and characterized first. The same, as we understand, is by way of a 'management fee' paid by the assessee to an investment advisor for managing his portfolio. Thus, as far as we see it, it is only a case of one appointing another for managing his affairs, so as to meet the constraints, including as to time, under which one may be placed, as well as to derive the benefit of the latter's skills and expertise, being professionals in the relevant field in the instant case. *The fee under reference, thus, acquires the character of an operational as well as agency cost.* The same would therefore stand to be allowed where the same gives rise to income or is toward earning income chargeable under the head 'income from other sources'. That no such income arises in a particular period, or though does, is at an amount less than the expenditure incurred, would be by itself of no moment as long as the primary intent and purpose for incurring the expenditure is to generate and earn the said income. The ld. CIT(A) has, after examining the scope of the activities being performed, found the same to be toward the following, and which finding is not in dispute and, rather, stands corroborated by the 'balanced fund' stipulation under which categorisation the assessee mandates his investment in the FTI account:

(a) safety of capital;

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(b) appreciation of capital; and

(c) dividend and income earning.

4.2 We shall take up each of the foregoing purposes which the impugned expenditure is incurred for and toward. As regards 'safety of capital', there can be no doubt with regard to its allowability where the accretion to capital (per which only, the same being subject to inflationary pressure, can the safety be ensured by, say, investing in low income and low risk securities), yields - or is supposed to yield - income by way of interest. On the other hand, if it, i.e., the safety of capital, is ensured in a manner so as to yield 'income', i.e., accretion to capital by definition, by way of capital gains, the expenditure by way of management fee or investment advisory cannot be allowed as deduction, even if the said capital gain is taxable in India. This would apply in equal measure to the other aspect of the investment advisory or portfolio management services, i.e., to yield appreciation of capital, returns from which would yield primarily capital gains. We may though clarify that when we speak of income, either by way of 'capital gains' or 'dividend or interest', the same would also include 'loss' under the respective heads, as investment being intrinsically a risky proposition, subject to market forces, no one can ensure only positive results, so that what we are concerned with here is the nature of the return *per se* and not its quantum. This is as the nature determines the head of income under which the 'income', which includes 'loss', stands to be assessed under the Act, so that only the deductions as mandated by the computation mechanism under the relevant head would follow or have to be necessarily adopted. The third object for which the services are being undisputedly availed is to earn income by way of interest and dividend. There is little doubt as to the allowability of the management fee expense against income arising in this manner. This is, as explained by the apex court in the case of *Rajendra Prasad Moody* (supra), the words 'for the earning of income' occurring in sec. 57(iii), do not imply a condition for income being actually earned or earned to an extent in excess of the expenditure incurred toward the same.

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True, the investment activity does not involve any expenditure on an ongoing basis; the fee relating to purchase and sale of securities being otherwise charged separately, i.e., on a transaction-wise basis. However, at the same time, it cannot be denied that investment in financial assets, particularly in the international market, is exposed to a dynamic and volatile environment, so that it is subject to several risks, making the investment activity a highly challenging and technical proposition. If, under such circumstances, the assessee has sought to bring the expertise of an investment advisor to bear in managing its portfolio, paying it an annual charge, the same, though on the basis of the value of the holding, cannot be said as not incurred for the purpose of earning income there-from. This, we also find to be the sum and substance of the decisions relied upon by the assessee.

4.3 The next question that arises is that as to the allocation, if so, of the expenditure, when the returns as per the investment strategy adopted is toward and, consequently, bound to be earned under different income heads, being 'capital gains' and 'income from other sources' in the instant case, and while being allowable in one case (the latter), is not so under the other (the former).

Toward this, we observe that the assessee seeks investment in a balance fund, implying a balanced risk disposition, so that it is neither in investments deemed risky nor can the assessee be said to be risk averse. This is as investments carry risks, including market risk, and the risk and return on an investment go hand-in-hand. The assessee's investment displays or is mandated to display a balanced risk appetite, being in bonds, which are low risk instruments carrying interest at a fixed rate, and equity shares, which – in general - bear relatively higher risk and, at the same time, yield higher returns, which is by way of dividend and capital appreciation. Within the risk profile adopted, the mandate is to obtain maximum results, i.e., returns. While the return on low risk instruments is largely by way of interest income, that from the higher risk category is largely in terms of capital gains. A good part of the returns are, thus, envisaged to be by way of 'capital gains', against which only sums as

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contemplated u/ss. 48(i) and (ii) can be allowed. It cannot thus be said that the entire management fee paid is for earning income by way of interest and dividend, which only are assessable under the head 'income from other sources'. In fact, even a 50-50 investment would, given the risk profile and the fact of investment in a balanced fund, yield higher returns or income by way of capital gains than by way of interest, as the same is primarily on bonds, i.e., low risk instruments, and risk and return are positively correlated. On being questioned in this regard, the ld. AR would show that the assessee has earned only marginal income by way of interest/dividend (for AY 2004-05, PB pg.1) and, in fact, has suffered a loss under the head 'capital gains'. That, to our mind, is of no moment, as the results of a particular year or what transpires in a particular year is not relevant. It is the purpose for which, and the intent with which, the investment is made, that is material, and which is not in doubt or even in dispute. Under the circumstances, we, therefore, only considerer it fit and proper that, given the investment mandate of a balanced fund, fifty per cent of the impugned management fee would stand to be allowed u/s.57(iii) of the Act against income by way of interest and dividends assessable u/s.56, irrespective of their quantum for the relevant year. We decide accordingly.

4.4 Before parting, we may clarify, even as afore-noted, that we have gone through and, rather, drawn upon the decisions cited by the assessee. Further, the decision stands taken on the basis of the appreciation of the facts.

5. In the result, the assessee's appeals for both the years are partly allowed.

Order pronounced on this 26th day of December, 2012

Sd/-	Sd/-
(B. R. MITTAL)	(SANJAY ARORA)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

MUMBAI, Date: 26.12.2012

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Copy forwarded to:

1. The Appellant.
2. The Respondent.
3. The C.I.T.
4. CIT (A)
5. The DR 'A' Bench, ITAT, Mumbai

BY ORDER

ASSISTANT REGISTRAR
ITAT, Mumbai Benches, Mumbai

Roshani