IN THE HIGH COURT OF BOMBAY AT GOA

TAX APPEAL NO.34 OF 2014

Commissioner of Income Tax,
"Aaykar Bhavan",
Patto, Panaji, Goa. .... Appellant

V/s

M/s. Sociedade De Fomento
Industrial Pvt. Ltd.,
Villa Flores Da Silva,
Erasmo Carvalho Street,
Post Box No.31,
Margao-Goa – 403601.
PAN NO.AABCS8860Q .... Respondent

Ms. Susan Linhares, Standing Counsel for the Appellant.
Shri S.S. Kantak, Senior Advocate with Ms. Vinita Palyekar, Advocate for the Respondent.

Coram: - M.S. SONAK &
DAMA SESHADRI NAIDU, JJ.

Reserved on: 30 September 2020
Pronounced on: 6 November 2020

ORAL JUDGMENT: (*Per Dama Seshadri Naidu, J.*)

Introduction:

The Assessee, dealing in mineral ores, claims that it has not incurred any expenditure for its earning the dividend income. So it claims an exemption under section 14A of the Income Tax Act. It also contributes some amount for the State to build a bridge across a river. That facilitates easy transport of its cargo. It wants the Revenue to treat that as revenue expenditure. But on both counts, the Revenue negatives. The appellate authority affirms those disallowances; the Tribunal reverses. Whose stand should this Court accept?

Facts:

2. The Respondent-Assessee mines and exports mineral ores. It filed e-return in September 2009 declaring a total income of ₹478,26,51,845/-. The Assessment Officer processed the income under section 143(1) of the Income Tax Act ("IT Act") and scrutinised the

account under CASS. In August 2010, the AO notified the Assessee under section 143(2) and heard its representative under section 129 of the Act.

3. Eventually, through Assessment Order, dated 28.12.2011, the AO concluded the assessment as follows:

i. Disallowance of expenses under section 14A, read with Rule 8D.

ii. Addition on account of foreign exchange loss.

iii. Addition on account of loss on the sale of assets.

iv. Disallowance of expenditure incurred for repair of Usgao bridge.

v. Disallowance of expenses out of community development.

vi. Income on account of sale of mines held by the firm to be treated as revenue receipts.

vii. The difference between sundry creditors and sundry debtors was added back to the income.

viii. Disallowance of bad debts written off.

ix. Disallowance of loss on transportation.

x. Suppression of closing stock on account of ground loss at berth No. 9.

xi. Capital loss carried on account of treating the income of a firm as business income.

4. Aggrieved, the Assessee carried the matter to the CIT (Appeals). By order, dated 20.12.2012, the Appellate Authority partly allowed the appeal. Then, against the appellate ruling, both the Assessee and the Revenue filed appeals before the Income Tax Appellate Tribunal, Panaji Bench, Goa ("the Tribunal"). Finally, the Tribunal, through its Order, dated 13.09.2013, dismissed the Revenue's appeal; it partly allowed the Assessee's appeal.

5. Against the Tribunal's Order, dt.13.09.2013, only the Revenue appealed to this Court under section 260A of the IT Act.

Substantial Question of Law:

6. Through its Order, dated 9 September 2014, this Court framed these substantial questions of law:

(i) Is the Tribunal right in deleting the additions made by the AO under section 14 A of the IT Act, read with Rule 8D of the IT Rules?

(ii) Is the Tribunal right in deleting the addition made by the AO on account of capital expenditure of ₹35,15,625/- by ignoring the decision of the Allahabad High Court in the case of *Raza Buland Sagar Co. Ltd. v. CIT(A)*[1], and also by ignoring section 37(i) which prohibits the allowing of capital expenditure?

The Questions Not Taken as the Substantial Questions of Law in this Appeal:

7. The Revenue in all has framed four substantial questions of law: (A) to (D). This Court has taken up the questions (A) and (C), not (B) and (D). The excluded questions are these:

(B) Is the Tribunal right in deleting the addition of ₹42.93 lakhs on account of excessive ground loss claimed by the assessee?

(D) Is the Tribunal right in holding that the compensation of ₹12,60,00,000/- received by the assessee on account of its retiring from the partnership firm is taxable under head 'capital gain income' by ignoring the decision in the case of *JCIT v. Khanna and Annadhanam*[2]?

We are, however, told that on those questions there are separate appeals pending.

Submissions:

8. Heard Ms Linhares, the learned Standing Counsel for the Revenue, and Shri Kantak, the learned Senior Counsel for the Assessee.

Discussion:

9. As we have already noted, the Assessee, a miner and exporter of mineral ores, for the AY 2009-10, filed e-return and declared a total income of ₹478,26,51,845/-. Its account was scrutinised under CASS,

1 [] (1980) 122 ITR 817
2 [] (2008) 115 TTJ 0663 (DELHI)

which resulted in reassessment. The AO made additions on eleven counts, amounting to ₹16,74,11,869/-.

10. Before the CIT(A), many issues have fallen for consideration. As the appellant, the Assessee had partial success. So, both the Revenue and the Assessee approached the Tribunal. Before the Tribunal, the Assessee succeeded substantially, though on a couple of issues it failed. That said, it has not chosen to appeal against the Tribunal's Order. It is only the Revenue that challenged the Order. So, we will confine ourselves to the substantial questions of law, leaving our peripheral issues.

Substantial Question of Law (I):

(i) Is the Tribunal right in deleting the additions made by the AO under section 14 A of the IT Act, read with Rule 8D of the IT Rules?

11. As the record reveals, the Assessee received dividend income of ₹13,85,03,376/-. It was exempted under the IT Act. The Assessee claimed that he did not incur any expenditure to earn that dividend. It is said to have invested surplus funds through the bankers and other financial institutions. The mutual fund officials used to come to the Assessee's doorstep to fill up the forms and to do all other things necessary in that regard. The Assessee only issued the cheques. The AO disagreed. He reckoned that without devoting time and without analysing the nature of the investment, the Assessee could not have invested in the mutual funds. The AO took the view that section 14A clearly applied to the Assessee's case. The AO accordingly invoked Rule 8D and computed the disallowance at 0.5% of ₹ 381,67,09,731/-, the average investment. Then, he disallowed ₹1,90,83,548/-. The Assessee appealed to the CIT(A). Indeed, the appellate authority confirmed the AO's disallowance. Of course, the Tribunal reversed it. Let us see whether the Tribunal's view is sustainable.

12. Section 14A, inserted by the Finance Act 2001 with retrospective effect from 1 April 1962, aims to disallow expenditure incurred in relation to income which did not form part of the total income under the IT Act. This section has to be read with Rule 8D, which

provides the method of calculation of disallowance. Section 14A statutorily recognises the principle that tax is leviable only on the net income. That is, the profits and gains of business or profession are taxed after deducting expenditure from income. In that regard, there is no need for the Assessee to establish a one-to-one correlation between income and expenditure. The provision reads:

> **Section 14A**. 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.

13. Rule 8D of the Income Tax Rules provides the methods for determining the amount of expenditure in relation to income not includible in the total income. But this Rule comes into play once an expenditure falls within the mischief of section 14A of the IT Act. We need not elaborate on that Rule.

14. In *Kanga & Palkhiwala: Law & Practice of Income Tax*[3], the learned revising author Arvind P. Datar has an interesting word about this 'inequitable and unfair' provision. According to *Kanga & Palkhiwala*, on a cursory reading, section 14A seeks to prevent a deduction that may result when income does not form part of the taxable income. But the

3 [ ] (Lexis Nexis, New Delhi, 11 ed. Online edition)

expenditure incurred to earn that income is allowable as a deduction. However, this section and Rule 8D have been amended several times. Those amendments have resulted in highly unfair consequences for Assessees who earn dividend income. The object of exempting dividend income under section 10(34) and income from mutual funds under section 10(33) was to encourage investments in shares and promote savings.

15. Dividends are not taxed in the hands of the shareholder, but it would be incorrect and anomalous, according to the revising author, to state that dividends are a category of income which does not suffer any tax. The object of section 14A is to disallow expenditure on income which has not suffered tax. That said, under section 115-O, the dividend is taxed at the time of distribution at the prescribed rate. That means, tax is paid by the company irrespective of whether an Assessee has income below the taxable limit. Had the dividend been paid directly to him, it would not have suffered tax. There is no provision to file any form seeking an exemption or to claim a refund of the dividend distribution tax for such Assessees. So, to disallow the expenditure in the case of dividend is not correct[4].

16. Section 14A refers to 'income which does not form part of total income under the Act'; it does not refer to 'income which does not form part of the total income in the hands of the assessee'. Then, *Kanga & Palkhiwala* takes note of the latest amendment under the Finance Act, 2020: that dividend distribution tax has been deleted. As long as the income is taxed, it should not attract section 14A, opines *Kanga & Palkhiwala.*

17. Recently, this Bench disposed of a batch of Tax Appeals in *CIT, Goa v. M/s. Sociedade De Fomento Industrial Pvt. Ltd*[5]. One of the substantial questions of law there was identical to the one before us. Rejecting the Revenue's contention, this Court has noted that the respondent invested certain funds in exempted categories such as mutual

4[] Ibid
5[] (High Court of Bombay, at Goa, Judgment, dated 22 October 2020)

funds; it earned income. During the assessment year, income from such sources stood exempted under section 10(35) of the IT Act. The only issue was whether the respondent incurred any expenditure while earning that exempted income and whether it included that expenditure in the common indirect expenditure of its own. First, the appellant noted, rather guessed, that the respondent borrowed funds to invest and that there ought to be an interest element. But the respondent asserted that it utilised its surplus funds. This Court, then, found that there was no material for the appellant to conclude that the respondent borrowed the funds. Second, given the volume of investment, the respondent is said to have received charge-free services from the managers of the banks and other financial institutions with whom they have invested. So there is said to be no expenditure.

18. This Court rejected the appellant's contentions and affirmed the Tribunal's findings. Here, too, we face an identical problem, similar assertions and counter assertions, and the same result: the Tribunal reversed CIT(A)'s findings. Can our response be different here?

19. Here, on facts, the Tribunal noted that the AO only discussed the provisions of section 14A(l) but has not justified how the expenditure the Assessee incurred during the relevant year related to the income not forming part of its total income. The AO, according to the Tribunal, straightaway applied Rule 8D. Indeed, there must be a proximate relationship between the expenditure and the tax-exempt income. Only then would a disallowance have to be effected. This Court, we may note, on more than one occasion, has held that the onus is on the Revenue to establish that there is a proximate relationship between the expenditure and the exempt income. That is, the application of section l4A and rule 8D is not automatic in each and every case, where there is income not forming part of the total income. No doubt, the expenditure under section 14A includes both direct and indirect expenditure, but that expenditure must have a proximate relationship with the exempted income. Surmise or conjecture is no answer.

20. We may further reiterate that before rejecting the disallowance computed by the Assessee, the Assessing Officer must give a clear finding with reference to the Assessee's accounts as to how the other expenditure claimed by the Assessee out of the non-exempt income is related to the exempt income.

21. So, we see no valid reasons to upset the Tribunal's well-reasoned judgment on this substantial question of law.

Substantial Question of Law (II):

(ii) Is the Tribunal right in deleting the AO's addition of ₹35,15,625/- as capital expenditure, by ignoring the Allahabad High Court's decision in *Raza Buland Sagar Co. Ltd.*, and also by ignoring section 37(i) which prohibits the allowing of capital expenditure?

22. On the facts, we may note that for the Assessee to reach Maina (the offloading point closest to the jetty) from Usgao, its people should cross a tributary of River Mandovi. There is no other way for the Assessee to transport the iron ore from the mines in Karnataka to Maina. Further, a portion of the ore procured from NS. Narvekar and Sancordem mines is also to be transported through this bridge over the tributary of Mandovi. Otherwise, the Assessee cannot access the loading point at Maina. But over time, this bridge has lost its strength and become precarious.

23. Under these circumstances, the Assessee contributed ₹35,15,625/- for the construction of the bridge. The question is, should this amount be treated as an item of revenue expenditure, as contended by the Assessee and as accepted by the Tribunal; or should it be treated as a capital expenditure, as contended by the Revenue and as accepted by the AO and CIT (A)?

24. We need not travel far to answer this question. A co-equal Bench of this Court has considered an identical question in *Commissioner of Income Tax v. Salgaocar Mining Industries Ltd.*[6]. In that case, during the AY 2008-09, the respondent company contributed over one crore to Goa Infrastructure Development Co. Ltd., a Government Undertaking. It

6 [ ] (per S.C. Gupte J, 9 July 2019)

was for the construction of Usgao bridge, which was said to be essential for the respondent's business. Then, a similar question as we face now arose.

25. In *Salgaocar Mining Industries*, the respondent-assessee relied on the Supreme Court's *LH Sugar Factory and Oil Mills (P) Ltd. v. CIT*[7], and Madras High Court's *CIT v. Coats Viyella India Ltd.*[8]. The appellant-revenue, on the other hand, relied on, as it has done here, Allahabad High Court's *Raza Buland Sugar co. Ltd.*, and also the Supreme Court's *Empire Jute Co. Ltd. v. Commissioner of Income Tax*[9].

26. As interpreted by *Salgaocar Mining Industries*, in *Raza Buland Sugar*, the State Government introduced a scheme for constructing staff quarters. For that, the appellant Assessee was to lease out its land near its factory to the UP Housing Board. As a matter of policy, the Government was to contribute some amount for constructing the staff quarters for various factories and the balance to be borne by the factory owners and contractor. These staff quarters were to remain the property of UP Sugar and Power Alcohol Housing Board, to be leased out to the factory owners on agreed terms. The appellant Assessee claimed the amount it had paid towards the cost of construction as the revenue expenditure. Then, the Allahabad High Court held that the quarters were freshly built and were exclusively used by the Assessee. Though the Assessee was not the owner, it was entitled to its exclusive use for an unlimited period. On this reasoning, the Court held the expenditure to be capital expenditure. But this Court in *Salgaocar Mining Industries* has observed that the Allahabad High Court had decided *Raza Buland Sugar* before the Supreme Court could render its ruling in *LB Sugar Factory and Oil Mills (P) Ltd.* so that Supreme Court's decision holds the key to our question.

27. In *LB Sugar Factory and Oil Mills*, the appellant was a private limited company, manufacturing and selling crystal sugar in a factory at Pilibhit in Uttar Pradesh. In 1952-53, the State of UP constructed a dam at Deoni. Besides, it also laid a road connecting the Deoni Dam with

7 [] [1980] 125 ITR 293 (SC)
8 [] [2002] 253 ITR 667 (Mad)
9 [] [1980] 3 Taxman 69 (SC)

Majhala. The Collector requested the appellant to contribute for the construction of Deoni Dam and the Deoni Dam-Majhala Road. So it did. In the same vein, the appellant also contributed another sum to the State of UP for its constructing roads in the area around its factory under a Sugarcane Development Scheme promoted by the State.

28. In *L. B. Sugar Factory and Oil Mills*, too, the Revenue argued that the newly constructed bridge and roads, though did not belong to the appellant, brought to it an enduring advantage for the benefit of its business. So the expenditure incurred by it was in the nature of capital expenditure.

29. First, the Supreme Court has acknowledged Lord Cave, L. C's dictum in *British Insulated and Helsby Cables Ltd. v. Atherton*[10]: "When an expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is a very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital." That said, *L. B. Sugar Factory and Oil Mills* has served a word of caution. According to it, this test is not of universal application and, as the parenthetical clause shows, it must yield where there are special circumstances leading to a contrary conclusion. To sustain that plea of non-universality, it has relied on Lord Radcliffe in *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.*[11]. That is, it would be misleading to suppose that in all cases securing a benefit for the business would be prima facie capital expenditure "so long as the benefit is not so transitory as to have no endurance at all". Then, it has quoted with approval its own earlier decision in *Empire Jute Co. Ltd. v. C. I. T.*[12] to hold thus:

> "[T]here may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, nonetheless, be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee that brings the case

10 [] (1926) 10 Tax Case 155 at p.189
11 [] (1965) 58 ITR 241 (PC)
12 [] (AIR) 1980 SC 1946)

> within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense, and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test."

30. *L. B. Sugar Factory and Oil Mills* has concluded that if the advantage consists merely in facilitating the assessee's business operations or enabling management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched the expenditure would be on revenue account, even though the advantage may endure for an indefinite future.

31. Thus, guided precedentially by all the above decisions, *Salgaocar Mining Industries* has accepted the Respondent-Assessee's contention that it is revenue expenditure.

32. So must it be here. We see no other compelling reason to take a different stand. We are, thus, constrained to hold this substantial question of law, too, against the Revenue.

Result:

33. For all the reasons we have stated above, we are satisfied that there is no error in the impugned judgment and order of the ITAT. So we answer the substantial questions of law against the Revenue and in favour of the Assessee. As a result, this appeal stands dismissed.

There shall be no order as to costs.

DAMA SESHADRI NAIDU, J. **M.S. SONAK, J.**

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