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Court : Income Tax Appellate Tribunal ITAT Ahmedabad

Decided On : Aug-04-2004

Reported in : (2004)91ITD311(Ahd.)

Judge : R Garg, Vice-, S Yadav

Appellant : Harish Krishnakant Bhatt

Respondent : The Ito

Judgement :

1. An interesting issue is raised in this appeal and that is whether the interest paid by the assessee of Rs. 5,69,739/- is an allowable deduction as the dividend income to which it pertained is not chargeable to tax in the hands of the shareholder. The shares were acquired by the assessee as an investor. These were acquired at the time when the dividend income was chargeable to tax. Dividend income not includible in taxable income, by virtue of insertion of Sub-section (33) to Section 10 of the finance Act, 1997 w.e.f. 1-6-97 and the tax is levied on distribution event directly on the company by virtue of another inserted Section 115-O of the same Act.

2. The AO formed an opinion that in view of the provisions of Section 14-A r w Section 10(33) & 115-O (w.e.f. 01-06-1997) the deduction could not be allowed in respect of expenditure incurred in relation to income, which did not form part of total income, which was dividend in this case. He further held that the interest expenditure could also be not allowed if the interest bearing loans had been

diverted for non-income bearing advances, the nexus of which was clearly proved in this case." 3. The assessee by letter dated 26-2-2002 stated that the expenditure by way of interest was mainly on investment of shares particularly when the dividend was taxable; that after amendment also, the dividend was still taxable and only the procedure for collection of taxes has been shifted from the shareholders to the company; that the expenditure was also otherwise allowable from the income earned by way of surplus on the sale of shares and this surplus was also considered as income under the IT Act and if the expenditure incurred is allowable under one head which results into income under other head, should not be disallowed because ultimately the income earning capacity of that asset should be considered that such investment also results into and is co-linked with the earning of remuneration, which is also offered for taxation; and that out of total liabilities of Rs. 134 lacs only Rs. 50 lacs was interest bearing liabilities and similarly out of total assets of Rs. 117.88 lacs, the non interest bearing assets were Rs. 16.12 lacs only in view of this the interest paid was claimed an allowable deduction.

4. The reply of the assessee as summarized above was not found to be convincing & acceptable by the AO and he gave the following grounds: "1 The assessee himself has mentioned in the letter dated 28-01-2002 that expenditure by way of investment is mainly in investment of shares particularly when dividend was taxable. This clearly shows that the interest bearing loans are directly attributable to investment in shares where from only dividend income is earned, which is exempt Under Section 115.). In view of Section 14A no deduction shall be allowed in respect of expenditure incurred in relation to income which does not form part of total income under this Act.

2 The assessee has also sought to contend that the amendment made in this respect is only a procedural amendment in the section since the dividend is still taxable, though, it is taxed in the hands of companies now. The assessee's thinking in this respect is also not correct since Section 14A is a substantive section & it clearly says that "no deduction shall be allowed". The fact that presently dividend is taxed in the hands of companies has no bearing on the taxability of the recipient of the dividend since the dividend income in the hands of

recipient is exempt as such it does not form part of total income in his hands.

3 The third issue raised by the assessee, regarding allowability of deduction from income which is earned by way of surplus on the sale of shares, is merely a hypothetical ground taken by him and the same is not supported by any factual position in this regard as no income by way of sale of shares have been shown in the return of income.

4 The assessee has also sought to contend that investment in shares is co-linked with the earning of remuneration, which is offered for taxation. In this regard it is contended that the company law does not provide any such co-linking of remuneration with the amount of share holding. There is no such provision in the company law that only those employee would get remuneration who have substantial share holding in the company. The company and its employees are both separate entities in the eyes of company law as well as IT Act." 5 "Thus in view of the facts as discussed above the contentions of the assessee were not found to be acceptable and the same was intimated to him vide letter dated 4-3-2002 which was served on 5-3-2002. However, as requested by him one more opportunity was provided to him and he was requested to personally appear before the undersigned on 11-3-2002 at 11.00 a.m. to discuss any other fresh issue, if he has any, in this regard. The assessee was also requested to furnish complete details / bifurcation in respect of his claim regarding non income earning assts being Rs. 16.12 lacs only out of total interest bearing liabilities of Rs. 50 lacs as no details thereof were furnished by him. In response to this the assessee did not appear personally but furnished a letter dated 9-3-2002 through his employee. In this letter the assessee has raised no new issue and he has merely repeated the same contentions which raised by him in the letter same contentions which raised by him in the letter furnished on 26-2-2002. These contentions of the assessee have already been rejectd as limited to him vide letter dated 4-3-2002. The assessee has also not furnished any details / evidences regarding his claim of non interest bearing assets being Rs. 16.12 lacs only. In view of these facts and further in view of the discussions made in the para 2 to 5 above the contentions of the assessee are rejected and his claim for interest expense of Rs. 5,69,739/- Under Section 57(iii) is disallowed and the same is added back to his total

income." 5. The CIT(A) upheld the disallowance by stating that on verification of the copy of account of M/s H.K. Finance, it was noticed that the opening credit balance in the name of M/s H.K. Finance was of Rs. 44,84,402/-. A further sum of Rs. 6,10,000/- was also borrowed from M/s H.K. Finance on different dates during the year under consideration. A closer examination of the sums borrowed during the year showed clear nexus between these amounts being transferred to parties from whom no interest or any other income has been generated during the year. It is further noticed no interest or any other income is shown to have been earned from Chitvan Club P. Ltd. & Pratiksha Chemicals during the year.

The above facts he observed clearly led to belief that the entire interest expense was directly attributable either to the dividend income of Rs. 9,754/- which is claimed exempt or the interest paid during the year showed a clear nexus of being transferred to parties from whom no interest or any other income has been generated. He further observed that in view of the provisions of Section 14-A r w Section 10(33) & 115-O (w e f 01-06-1997) the deduction could not be allowed in respect of expenditure incurred in relation to income from dividend, which did not form part of total income. The plea for allowance on the ground that the expenditure by way of interest was mainly on investment of shares at a time when the dividend was taxable was not accepted because the law applicable to the facts of the case was the law as existed during the relevant assessment year when the dividend income was non taxable and hence the interest was to be disallowed. As regards the argument that the dividend is still taxable and only the procedure for collection of taxes has been shifted from the shareholders to the company, he held, that because in the hands of the shareholder the dividend income has become non taxable and hence the disallowance of interest was quiet justified. The plea that the capital gain is still taxable on the sale of shares and hence the expenditure was not in the case of capital gain but, was in respect of exempted income. Considering the provision of Section 14A r. w. Section 10(33) & 115-O the interest claimed by the assessee he held cannot be allowed because the interest bearing loan had been utilized for making investment in the relation to exempted income. He therefore confirmed the disallowance made by the AO amounting to Rs. 5,69,739/-.

6. The learned counsel of the assessee Shri S.N. Soparkar submitted that dividend though not taxable directly in the hands of the assessee, it is assessed in the hands of company and therefore Section 14A has no application. Reliance is placed on the decision of the Bombay Bench of the Tribunal in the case of M/s Mafatlal Holdings Ltd. (ITA No.2935/Mum/2002 for AY 1968-99 dated 23-4-2003). The facts and circumstances of that case are similar to the facts of the impugned case and therefore he submitted that Tribunal following that view should allow the claim of the assessee and should not take a contrary view of the matter. He further submitted that originally when the investment was made in shares the interest at that time was relating to taxable income from investment, it cannot be disallowed in subsequent years when the dividend became non-taxable. He placed reliance on the case of Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT 227-ITR-127 (SC). It is further submitted that originally allowed in 143(1) and therefore disallowance in 143(3) amounts to enhancement which is prohibited by the Proviso to Section 14A of the Act disempowering the AO 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 the assessment year beginning on or before the 1st day of April 2001. He further submitted that the interest is paid on borrowings utilized for the acquisition of the shares which give rise to partly taxable source viz. capital gain and therefore no disallowance is warranted by applying Section 14A of the Act. Reliance is placed on the decision of the Supreme Court in the case of Rajasthan State Warehousing Corporation 242-ITR-450. Reliance is also placed on the decision of the Supreme Court in the case of Rajendra Prasad Moody (115 ITR 519 (SC) holding that there need not be any income for allowing deduction and therefore when there is a possibility of earning capital gain that would be a source of income and Section 14A would not be applicable. Reference is also invited to the decision of the Supreme Court in the case of Cocanada Radhaswami Bank Ltd. 57-ITR-306(SC) holding that head is not decisive and what is to be seen is the income from that source.

7. The learned DR placed reliance on the decision in the case of Kalindi Investment P. Ltd. 260 ITR 261(Guj) and submitted that as the interest is allowable against income from other sources, the same cannot be allowed under the head

capital gain. He also referred to Bombay High Court decision in the case of K.J Somatiya and Sons P. Ltd. 155-ITR-605 (Bom) in support of disallowance by the AO. He further submitted that the Mumbai Bench decision is not an authority on the issue in as much as it has not discussed the implication of Section 14A in right perspective and that it was otherwise also a case of trader in shares. It has not taken into consideration the legal position that a shareholder and the company are two distinct and separated entities and the tax paid by the company does not per se makes the dividend a part of shareholder's total income. He further submitted that an intimation Under Section 143(1) is not an assessment and therefore the question of enhancement of income or rectification thereof does not arise. When the interest is claimed this year and when dividend is not part of total income of this year the fact that it was taxable when acquired does not make any difference. It is not a mere change of head of income but absence of income all together and capital gain has not arisen in the year at all. He therefore submitted that the order of CIT(A) upholding the disallowance does not call for any interference.

8. We have heard the parties and considered their rival submissions. In the present case we are concerned only with acquisition of shares on capital account and the taxability of dividend income which was chargeable under the head "income from other sources" before introduction of Section 10(33) of the Act which excludes dividend income from the computation of total income of an assessee. Section 10(33) reads as under:- "10. In computing the total income of a previous year of any person, any income falling within any of the following Clauses shall not be included- 9. Section 115-O referred to in Section 10(33) (i) above provides for taxability of dividend declared in the hands of the company itself. It reads as under: "115-O (1) Notwithstanding anything contained in any other provision of this Act and subject to the provisions of this section, in addition to the income tax chargeable in respect of the total income of a domestic company for any assessment year, any amount declared, distributed or paid by such company by way of dividends (whether interim or otherwise) on or after the 1st day of June, 1997, whether out of current or accumulated profits shall be charged to additional income-tax (hereafter referred to as tax on distributed profits) at the rate of ten per cent.

(1A) Notwithstanding that no income tax is payable by a domestic company its total income computed in accordance with the provisions of this Act, the tax on distributed profits under Sub-section

(1) shall be payable by such company."

10. Section 14A provides for disallowance of expenditure incurred in respect of income not forming part of total income under the Act. It was introduced by Finance Act 2001 with retrospective effect from 1-4-1962 and it reads as under:- "14A-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."

11. The interest paid on borrowing for acquisition of shares had been held by Supreme Court in Rajendra Prasad Moody (115-ITR-519) to be an allowable deduction Under Section 57(iii) as it is an expenditure incurred for earning and making income from dividend. In this, the Supreme Court held that when the assessee borrowed monies for the purpose of making investment in certain shares and paid interest thereon during the accounting period relevant to the assessment year but did not receive any dividend on the shares purchased with those monies, the interest on borrowed monies for investment in shares which had not yielded any dividend was admissible as a deduction Under Section 57(iii) of the IT Act, 1961 in computing its income from dividend under the head "Income from other sources". The Supreme Court further observed that "The plain natural construction of the language of Section 57(iii) of the IT Act, 1961, irresistibly leads to the conclusion that to bring a case within that section it is not necessary that any income should in fact have been earned as a result of the expenditure. What Section 57(iii) requires is that the expenditure must be laid out or expended wholly and exclusively for the purpose of making or earning income. The section does not require that this purpose must be fulfilled in order to qualify the expenditure for deduction: it does not say that the expenditure shall be deductible only if any income is made or earned." What this decision says is that actual earning of dividend is not necessary to allow the expenditure and it would be sufficient to claim the deduction of interest paid on borrowings which have been used in

acquiring the shares. The shares were acquired by the assessee in earlier year when dividend was taxable under the head "other sources" Under Section 56 and interest paid by the assessee has been claimed and allowed in earlier years as having been incurred for earning and making income from dividend. There is thus no dispute that interest payment in this case is an expenditure incurred for making or earning income from dividend. In view of the provisions of Section 10(33) of the Act, there is also no dispute that dividend received by the assessee does not form part of its total income. That being so, the provisions of Section 14A providing for disallowance of expenditure incurred by the assessee in relation to income which does not form part of total income under the Act come into play. Apparently, therefore, the expenses incurred by the assessee in relation to such dividend income cannot be allowed as a deduction in computing the income of an assessee under Chapter IV of the Act, namely, under the five heads stated therein for "Computation of total income."

12. The "total income" is defined in Section 2(45) to mean "the total amount of income referred to in Section 5, computed in the manner laid down in this Act. Section 15 to 59 of the Act provide for as how to quantify the total income chargeable to tax and lay down the rules for computing income for the purpose of chargeability to tax under the five heads as mentioned in Section

14. The permissible deductions enumerated in sections 15 to 59 are to be allowed only with reference to income which is brought under one of the heads in Section 14 and when forms part of total income. If any income is not part of total income the expenditure / deductions though of a nature specified in sections 15 to 59 but related to the income not forming part of total income, cannot generally be allowed or considered against other income which are includible in the total income for the purpose of chargeability to tax.

Thus, the deduction for interest paid in respect of capital borrowed for the purpose of acquiring shares held as investment can be allowed for the purpose of acquiring shares held as investment can be allowed only against dividend income which is includible in the total income for the purpose of chargeability to tax under the Act and not otherwise. The expression "for the purpose of charge of income tax and

computation of total income" used in Section 14 amply clarifies the intention of the Legislature and the Scheme of the IT Act, 1961. Thus there could be no such intention of the Legislature and a Scheme of the Act to allow deductions related to income not forming part of the total income, against the income includible in the total income and chargeable to tax. This is what is the import of the Supreme court decision in the case of Tuticorian (supra). It was held that the expenditure incurred by the assessee for the purpose of setting up its business could not be allowed as deduction, nor could it be adjusted against any other income under any other head. Similarly any income from a non business source could not be set off against the liability to pay interest on funds borrowed for the purpose of purchase of plant and machinery even before commencement of the business of the assessee.

It is held that the assessee may be entitled to capitalize the interest payable by it. But what the assessee cannot claim is adjustment of this expenditure against interest assessable Under Section 56. Section 57 of the Act sets out in its Clauses (i) to (iii) the expenditures which are allowable as deduction from income assessable Under Section 56.

13. We may refer to in this context the decisions referred to by the learned DR on this point dealing with the situations of deductibility of expenditure with respect to interest on borrowings Under Section 57(iii) of the Act. One is of Gujarat High Court in the case of Kalindi Investment P. Ltd. (supra). Where the assessee company borrowed the money for purchase of shares and the entire capital asset was thus not having income which could fall with the head "Income from business or profession" or any other heads specified in Section 14 of the Act. The assessee company admittedly claimed deduction of interest against income from other sources, i.e., dividend and interest income, but such dividend and interest income was not earned from the investment in shares or any other investment which was relatable to the transaction in question. In these circumstances, the Gujarat High Court held that there was no making or earning of income relatable to the transaction in question. The source of income, viz., the shares, stood transferred and hence the purpose for which the borrowing had been made, stood frustrated. It was held that in fact the expenditure had not been incurred for preserving and

maintaining the source of income nor was it a case where the assessee had no option except to incur the expenditure. Their Lordships of the Gujarat High Court held that as under : "Section 57(iii) of the Act is relatable to deductions allowable against the income chargeable under the head - "Income from other sources". As to what is income from other sources is laid down in Section 56 of the Act which specifically states that it is income which is not chargeable to income tax under any of the heads specified in Section 14, items A to E. Therefore, on a conjoint reading of the various provisions of the Act and applying the said provisions and the facts found by the Tribunal it is apparent that the assessee company was not carrying on any business and thus was not having income which would fall within the head "Income from business or profession" or any of the other heads specified in Section 14 of the Act. The assessee company has admittedly claimed deduction of interest against income from other sources, i.e.

dividend and interest income, but such dividend and interest income is not earned from the investment made in the shares of Telerad P. Ltd. or any other investment made which is relatable to the transaction in question. Therefore, on a plain reading of the provision in the light of the facts found there is no making or earning of income relatable to the transaction in question. The next question that would arise that in the light of the settled legal position : it is not necessary that any income must actually have been earned for the purpose of claiming deduction, do the facts of the case go to show that even that condition is applicable The Tribunal has found from the facts that the source of income (shares) has altogether disappeared. In relation to this finding Mr. Karia during the course of his submissions contended that the Tribunal had committed an error in recording this finding because what had happened was that the assessee company had converted from one form of investment to another form of investment when the shares of Telerad P. Ltd. were transferred to Ofisade P. Ltd. and it was stipulated as per the agreement that the consideration shall be received in instalments spread over a period of eight years. This contention requires to be stated to be rejected, because it is the consideration for transfer of shares which is payable in instalments and that too without interest. It is not as if non receipt of consideration is a form of investment by way of interest bearing deposit; if it was so, the contention might have deserved consideration. Even otherwise, the borrowing was

not for the purpose of investment by way of outstanding dues. Further more, even if for the sake of argument it is accepted that the outstanding dues would be a form of investment, yet in the face of the fact that the same was not interest bearing it cannot be said that the borrowing had been utilized for the purpose of making or earning income.

On the other hand, the Tribunal has found that the source of income, viz., shares stood transferred and hence the purpose for which the borrowing had been made, stood frustrated. In fact the expenditure had not been incurred for preserving and maintaining the source of income nor was it a case where the assessee had no option except to incur the expenditure, but on the contrary, the assessee had the option, viz. it was not necessary for the assessee to transfer the shares of claiming the deduction and yet the assessee exercised the option the other way by transferring shares which had no connection with the making or earning of the income. Moreover the Tribunal has found that at the highest even on the facts as placed by the assessee on record, the purpose of the borrowing was not the sole purpose but was a mixed purpose including reorganization of the investments of the assessee company and even on that count the deduction was not permissible." 14. In the case of K.J. Somaiya and Sons P. Ltd. (supra), the assessee company was acting as a managing agent. It borrowed a sum of Rs. 31½ lakhs for purchasing certain shares and the shares were donated to a charitable trust within a month of their acquisition. The assessee claimed that the interest paid on the borrowed amount was deductible under Section 57 of the Act. The assessee in that case is a private limited company and was acting as managing agent of Godavari Sugar Mills Ltd. during the relevant years. It also derived income from certain investments. It also received interest on advances made by it.

On March 30, 1967, the assessee purchased from Mr. K.J. Somaiya 2500 shares of Godavari Sugar Mills Ltd. for a sum of Rs. 3,50,000/-. The assessee did not have funds immediately available for paying the full consideration. It was, therefore, agreed that the purchaser should pay the price in instalments carrying interest at 10%. Immediately on acquisition, and it is agreed that the time interval was not more than a month, the shares were donated to a charitable trust known

as K.J.Somaiya Trust. This was some time in April, 1967, although the exact date of donation is not on the record. Interest of Rs. 5833/- was paid by the assessee to the said Mr. K.J. Somaiya for the AY 1968-69 and the said payment is the basis of question No. 1 for the said assessment year. Similarly, for the next assessment year, that is 1969-70, the assessee paid interest of Rs. 35,000 also to the said Mr. K.J. Somaiya.

All the three authorities below, namely, the ITO, the AAC as well as the Tribunal, have rejected the claim of the assessee for being allowed deduction of this interest. This was on the basis that the interest was not paid for acquiring any income earning asset but for acquiring an asset which was meant to be immediately donated to a charity. That the assessee had this intention can be gathered from the circumstances and particularly bearing in mind the very short time interval between the acquisition of the assets and its donation to the charitable trust. On reference the High Court upheld the order of disallowance by observing: "This is precisely the basis on which the Tribunal disallowed the claim of the assessee. If we peruse the provision of Section 57 of the IT Act, 1961, we find that the view of the Tribunal is there is little that can be urged against either the approach or the ultimate conclusion of the Tribunal in respect of the interest paid." 15. Such an intention has been clarified in the the provisions of newly inserted Section 14A by the Finance Act, 2001, with retrospective effect from 1-4-1962 and as well as in the memorandum explaining the provisions, notes on clauses relating to the Finance Bill, 2001 and in the Board's Circular No. 14 of 2001, dated 22-11-2001 and Circular No.8 of 2002, dated 27-8-2002 in the following way: "Certain incomes are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income.

This is against the basic principles of taxation whereby only the net income, i.e. gross income minus the expenditure, is taxed. On the same analogy, the

exemption is also in respect of the net income. Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income.

It is proposed to insert a new Section 14A so as to clarify the intention of the legislature since the inception of the IT Act, 1961 that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the IT Act." 16. It is thus clear, that from whatever angle one may look at the transaction, result is the same, viz., when the dividend is not taxable at all, the interest pertaining to that would also not be allowable because there is no taxable income of the assessee against which such interest can be allowed : the another way to consider the issue is that if interest is allowable, it would be allowable against dividend income and the net dividend income after allowing that, alone would be excluded from total income Under Section 10(33). Section 14A was inserted to clarify this intention of the legislature to set the existing controversy on this issue at rest.

17. In the present case, we find that the borrowed money has been utilized in purchase of shares held as investment. As the monies borrowed has been utilized in purchase of shares held as investment, the interest paid on so borrowed monies is allowable against the income from dividend on such shares irrespective of whether or not there is any yield of dividend on the shares purchased and held as investment.

In other words the interest incurred is relatable to earning of dividend on the shares purchased and held as investment. The dividend income is now exempted from tax by virtue of Section 10(33) of the Act and, therefore, as a consequence thereof, the interest paid on borrowed capital utilized in purchase of shares held as investment, being the expenditure incurred in relation to dividend income not forming part of assessee's total income, cannot be allowed as a deduction. There is no chargeable income against which it can be allowed as a deduction. It cannot also be allowed against any other taxable income inasmuch as the interest so paid is not relatable to the earning of taxable income. This is what is provided by the legislature in the scheme of the IT Act even without the existence of Section 14A of the Act with retrospective effect from 1-4-1962.

18. As regards the first proposition of the learned counsel of the assessee that the dividend has been assessed in the case of the company and therefore Section 14A does not apply, we may observe that income tax is a levy on a person and not on the income though it is charged in respect of total income and this is evident from the charging Section 4 which provides that where any Central Act enacts that income tax shall be charged for any assessment year at any rate or rates, income tax at that rate or those rates shall be charged for that year in accordance with and subject to the provisions (including provisions for the levy of additional income tax) of this Act in respect of the total income of the previous year of every person. Thus income tax as well as levy of additional income tax is a tax in respect of total income and it is levied on a person. It is thus a personal tax levied on a person on his total income. Section 115-O levies the additional tax on the company and it will be the additional tax within the meaning of and mentioned in Section 4 of the Act.

19. Under Section 115-O the tax payable by domestic companies is an additional tax at the specified rate on an amount declared, distributed or paid by such company by way of dividends whether interim or otherwise and whether out of current or accumulated profit, and this additional tax is in addition to the income tax chargeable in respect of the total income of said company. The company has thus been made liable to additional tax on its distributed profits by way of dividend.

It is not the tax in the hands of the share holder. It is also not the tax payable by the domestic company Under Section 115-O is paid out of the amount declared or distributed or paid by way of dividend to the shareholder. It is the tax paid with respect to and on the amount of dividend declared, and not out of the amount of dividends so paid to the shareholder. The tax so paid by the company cannot be regarded as tax paid by the shareholder as the both are distinct and separate legal and taxable entities as aforesaid. In our opinion, it would be wrong to say that the tax paid by the company Under Section 115-O is a change of mode of tax paid by the shareholder on the dividend income. The amount paid to the shareholder by way of dividend is the full amount that is declared as dividend by the company in its general meeting and not the amount after deducting the tax payable by such company Under Section 115-O of the Act on the amount of dividend declared or distributed or paid to the shareholder. Before the insertion of Section 115-O and

Section 10(33) of the Act, the full amount of dividend declared by the company was being paid to the shareholder but subject to deduction of tax at source. The dividend received by the share holder was includible in the computation of total income and as such it was chargeable to tax before insertion of Section 10(33) in the Act. But now the dividend received by the shareholder from a domestic company is not includible in the total income by virtue of newly inserted Section 10(33) of the Act and as such it can be regarded as income not chargeable to tax. In both the situations, i.e. before and after the insertion of Section 10(33) of the Act, the only difference lies in the fact that before insertion of Section 10(33) in the Statute the dividend declared by a company was includible in the computation of total income and consequently was chargeable to tax, after insertion of Section 10(33) the dividend declared by a company referred to in Section 115-O i.e.

dividend declared by a domestic company, is not at all includible in the computation of total income, and thus is not chargeable to tax.

Unlike earlier under the new provisions, the amount declared or distributed or paid by a domestic company by way of dividend is fully retained by the shareholder without incurring any liability to pay tax on the said dividend amount either by himself or through the company.

The shareholder has nothing to bear towards the tax liability of a company payable Under Section 115-O of the Act. this incidence of tax Under Section 115-O is borne by the company itself and is not passed on to the shareholders. In this view of the matter, we can say that the amount declared or distributed or paid by way of dividend has not suffered any tax in the hands of a shareholder. It is fully exempted in his hand by virtue of Section 10(33) of the Act.

20. Even otherwise the company and shareholders are two different entities and tax paid or payable by the company is not the tax paid or payable by the assessee shareholder. Let us see the inter-se relationship between a company & shareholder. The first precedent on this is of 19th Century in the case of Solomon v. Soloman and Co.

(1897) AC 22 stating that the company and the shareholder, even where the beneficial ownership is owned by one person, are two different entities. A company is, under the general law, a juristic person different legal entity from its shareholders. The share holders have no right in the assets of the company except when dividends are declared or when the assets of the company are distributed on liquidation. Being a distinct separate taxable entity a company is an assessee by itself under Section 2(31) of the Act, and is chargeable to income tax. As long back as in 1921 the Privy Council in *IRG v. Blott* the House of Lords (1921) 2 AC 171 held that "Plainly a company paying income tax on its profits does not pay it as an agent for its shareholder. It pays as tax payers, and if no dividend is declared the shareholders have no direct concern in the payment thereof. In another case of *Hamilton v. IRC* 1931 KB 492 it was observed that "the company is one tax payer and each individual shareholder is another and a separate tax payer, on whose behalf the company deducts a tax which it pays a dividend, but on whose behalf it is not paying the tax when it pays its own tax to the crown." This is the view upheld by the Supreme Court in the case of *Purshottamdas Thakurdas* 18 ITR 206(SC). It says that when a company pays tax, it does so in discharge of its own liability and not behalf of, or as agent for, its shareholders.

21. The Indian Income tax Act, 1922 however made a departure to general legal position and provided if a company pays a tax, proportionate amount was to be increased to dividend receipt for inclusion in total income of the shareholder and grossed up amount was to be deemed to the tax paid by the shareholder. This system is now given up in the IT Act, 1961 and the original position was restored, i.e. company is taxed on its total income and the shareholder's tax was deducted at source from the dividend so declared and given credit to the share holder instead of allowing a credit of proportionate tax paid by the company treating the grossed up amount as deemed to have been paid by the assessee.

22. Recently a case came up before the Supreme court in the context of additional tax Under Section 104 for withholding profits and not distributing as dividend in the case of *S. Radhakrishnan and Anr.* 254 ITR 561 and the court made the following order: "The respondent has been served but does not appear. The respondent

objected to the inclusion of a sum of Rs. 34,375/- representing the gross dividend from a company called BMS P Ltd. for the AY 1972-73.

The assessee's case was that, by virtue of Section 104 of the IT Act, 1961 the said amount had already suffered tax because it was undistributed profits in the hands of the company ; when it was distributed to the company's shareholders thereafter, the levying of further tax thereon amounted to double taxation. The objection was rejected by the authorities, whereupon a writ petition was filed before the High Court. By the order under appeal, a learned single Judge upheld the case of the assessee on the basis that taxation of the same amount in the hands of the company and the shareholder amounted to double taxation. The learned judge was in error. The question of double taxation must be decided having regard to who the assessee is. If the assessee is different, the question of double taxation would not arise. In the present case, the fact that the company had been made liable to tax on the amount did not mean that that amount, when paid as income to the shareholder, could not be taxed as income in the hands of the shareholder. The character of the amount changed, it being now the income of the shareholder. In the premises, the appeal is allowed. The judgment and order under appeal is set aside. The writ petition filed by the respondent in the High Court dismissed."

23. Section 14A provides for disallowance of expenditure in relation to income which does not form part of the total income. It is assessee's own total income that is to be seen for applying the provisions of Section 14A and not that of somebody else. Admittedly by virtue of Section 10(33) dividend income is not includible/included in total income of an assessee shareholder. In other words by virtue of Section 10(33) it does not form part of the total income of shareholder and therefore the expenditure incurred by the shareholder in earning that income would not be allowable.

24. In the light of the above let us discuss the decision of Mumbai Bench (supra). This decision on which assessee places heavy reliance discusses this issue as under:- "17 We also do not find any substance in the contention of the department that dividend earned by the assessee is fully exempt under the IT Act, 1961. During the relevant assessment year, dividend income received by the shareholder and as referred in Section 115-O was exempt under Section 10(33) of the

IT Act, 1961.

As per the provisions of Section 115-O, a company declaring, distributing or paying any dividend is liable to deduct tax at certain rate on the amount of dividend declared, distributed or paid. As soon as a company declares dividend in favour of its shareholder, the dividend income, declared becomes income receivable by the share holder. Thus, if tax is paid out of such dividend declared whether by shareholder directly or by the company in a indirect manner, it is the dividend income which has suffered tax.

In fact dividend declared by the company is the income of the shareholder. Before the existing provisions of Section 115-O, the dividend income was taxable in the hands of the shareholders. Now as per the provisions of Section 115-O the tax is being deducted by the company out of dividend declared, distributed or paid to the shareholder. Thus, the dividend income, which belongs to the shareholder has suffered tax either in the hands of the company or in the hands of the shareholder. The shareholder has received the net income in both the cases. For example if the total dividend declared by the assessee company is Rs. 1000 and the tax paid by the shareholder on this amount is @ 10% then the net income remains in the hands of the shareholder is Rs. 900 only. But as per the provisions of Section 115-O, if the company is deducting tax @ 10% out of the dividend declared of Rs. 1000, the share holder in that case would also get income of Rs. 900. Thus in both the cases the shareholder is getting the net income of Rs. 900 after the deduction of tax whether the tax is deducted in the hands of the shareholder or in the hands of the company under the circumstances it cannot be said that the dividend income received by the shareholder is exempt.

The only difference, which has been made by the provisions of Section 115-O is that the incidence of tax is shifted from the shareholder to the company. We, therefore, find force in the arguments of the learned counsel that the dividend income received by the assessee is in fact not exempted from tax but the incidence of tax has been shifted from the shareholder to the company.

Ultimately it is the income of the shareholder, which is being assessed either in his own hands or in the hands of the company. The contention of the department that

the dividend income is exempted from tax and, therefore, no expenditure can be allowed against that income is without any substance.

"18 The various Courts cases relied upon by the learned DR are not relevant to the facts of the present case. In the case of Oriental Investment Co Ltd. (supra), the Hon'ble Apex Court held that the mere fact that the company has within its objects the dealing investment in shares does not give to the company the characteristics of a dealer in shares, but if order circumstances are provided it may be relevant for the purpose of determining the nature of the activities of the company. In the present case the assessee company actually carried out business activity during the year under consideration, which can be evidenced from the balance sheet for the FY ending on 31-3-98. It could be observed from the balance sheet that there were various business transactions carried on by the assessee company during the financial year of the nature of selling its investment utilization of the opening cash and bank balances, procuring unsecured loans during the financial year and utilization of the said funds for its business purposes. Thus, the assessee company had carried on the activities of all the ingredients of investment and finance company. Thus, the assessee company was not only having its objects in dealing with the investment shares but there were other circumstances as stated above which proved undoubtedly that the assessee company was an investment company. Therefore, the above Supreme Court decision have moreover supported the case of the assessee company that the company was actually dealing in the business of investment in shares. In the case of Challapalli Sugars Ltd. (supra), the Hon'ble Supreme Court laid down that if the interest paid on the amount borrowed for acquiring and installing machinery and plant for a period prior to commencement of production the same would actually form part of the actual cost of machinery and plant. In the present case as we have discussed above in detail the assessee company carried on the activities of the nature of purchase and sale of shares, had earned dividend income and had also incurred various business expenditure like legal and professional expenses, staff expenses, stamp expenses, bank charges etc. which have also been allowed by the AO. Therefore, the interest expenditure incurred by the assessee is also allowable under the provisions of Section 36(1)(iii) as the assessee company was in fact carrying on the business activities during the year under consideration. In the case

of Ace Investment P Ltd. (supra), the Madras High Court has held "that the mere presence of the objects clause would not be sufficient to hold that the assessee was carrying on money lending business. It was clear on the facts that the amounts advanced were short term advances and they were advanced only to the fourteen trusts. The assessee had not advanced money to any other person. The rate of interest charged was 6 per cent which the Appellate Tribunal considered low when compared to the market rate of the interest prevalent at time. Moreover, the interest was collected only after the payment of the principal sum.

The appellate Tribunal also found that the persons to whom the advances were made were closely connected with the assessee. There was no systematic or organized activity carried on by the assessee in dealing with the money. Therefore the Tribunal was right in holding that the income of the assessee could not be regarded as income derived from money lending business and it was derived from the deposits or investments made." In the present case the company carried on the business activities during the year under consideration; there were also various business transaction as we have stated above. The assessee procured unsecured loans during the financial year and these sums were utilized for the purpose of the business of the assessee. The assessee company also made investments in shares and also earned dividend income, therefore, it cannot be said that the assessee company made short term advances. It also cannot be said that the assessee company was not carrying on the business systematically or in an organized manner. The assessee company was carrying on the business as an investment and finance company and these activities of the company were systematic.

Therefore the facts of the above case of the Madras High Court held that the dividend earned by the assessee company from investments in shares of companies carrying on tea business would never be said to be part of its business income because investment in shares were not incidental to the assessee's business activities and they were not held as trading assets. But in the present case, the main business of the assessee was investment in shares. The assessee company carried on the activities in respect of all the ingredients of an investment and finance company. Therefore, the main business of the assessee was to deal

in investments and hence, the dividend income earned by the assessee was income from the main business carried on during the relevant assessment year. The facts of the above said case are not relevant to the facts of the present case because in the above said case the assessee was earning the dividend income from its investment in shares, which was not the part of the business income of the assessee. In the case of Rajendra Prasad Moody (supra), the Hon'ble Supreme Court held that the interest on monies borrowed for investment in shares which had not yielded any dividend was admissible as deduction Under Section 57(iii) of the IT Act, 1961 in computing its income from dividend under the head "income from other sources". We do not find any relevance of this case to the facts of the present case. In the present case the question of deduction has to be allowed under the provisions of Section 36(1)(iii) or Under Section 37(1) of the Act. The dividend income earned by the assessee is out of its investment in shares and this is the main activity of the assessee company. Therefore the dividend income earned during the year is income of the assessee from business and not income from other sources. In view of the discussion above, the disallowance made by the tax authorities is not justified. We, therefore, allow the claim of allowance of interest payment as business expense and the disallowance made by the AO and confirmed by the CIT(A) is deleted. As we have allowed the claim of the assessee (supra), therefore, the alternative claim made by the learned counsel, does not require any consideration.

These grounds of appeal are therefore, decided in favour of the assessee." 25. It has taken the view that the dividend income received by the assessee is in fact not exempted from tax but the incidence of tax has been shifted from the shareholders to the companies. In the said decision of Mumbai Bench, the decision of Supreme Court in the case of S Radhakrishnan and Another (supra) was not brought to its notice and hence not considered. The Supreme court held that the fact that the company has been made liable to tax on certain amounts did not mean that that amount, when paid as income to the shareholders, could not be taxed as income in the hands of the shareholders. The character of the amount has been changed, it being now the income of shareholders. This principle laid down by the Supreme Court in the above referred case has not been taken note of by the Mumbai Bench. Moreover, the settled position of law as discussed above in this order, with

regard to the inter se relationship between the company and its shareholders as laid down by the Supreme Court in the case of Calcutta Tramways Co Ltd. 86-ITR-1333 (SC), Kesoram Industries and Cotton Mills Ltd. (supra) and Purshottamdas Thakurdas 59-ITR-769 (SC) were also not considered by the Mumbai Bench in the case of Mafatlal Holdings Ltd. 48-ITR-206 (SC).

These principles laid down in the said decisions of Supreme Court, have not been brought to the notice of the Mumbai Bench.

26. Further the Bombay Bench had proceeded on the basis that the tax is paid by the company on such dividend but that is not exactly the issue to be looked into. What one has to see is whether the expenditure incurred by the assessee was in relation to income which does not form part of the total income. As aforesaid by virtue of section of Section 10(33) the dividend does not form part of total income of shareholder.

Thus, once the dividend income does not form part of assessee's total income, Section 14A comes into play instantly and thereafter it would be besides the issue as to who paid the tax on the dividend declared. The Bombay case was also a case of trader and as is evident from para-18 of that order extracted above where different consideration may apply because of expenditure would not only be dividend but profit on dealing in shares. In the present case we are not concerned with the acquisition of shares by the assessee in the course of dealing in shares.

27. We agree with the submission of the assessee that generally the decision of a co-ordinate Bench should be followed. But that is not the universal rule and it is subject to certain exceptions. With regard to the circumstances and the situation under which a co-ordinate Bench may come to a different conclusion than that of another Bench, we may refer to a decision of ITAT Ahmedabad Bench "A" in the case of Mira Industries 87 ITD 475 (Ahd) wherein, after reviewing various decisions of Hon'ble Supreme Court and High Courts, the Tribunal has made the following observations:- "From the above it is clear that an earlier order of co-ordinate bench has a great persuasive value and it should not ordinarily be deviated from. This principle, however, is subject to certain limitations, namely, (i) the facts are same, (ii) no new facts are brought on record, (iii) no change in the

circumstances under which the decision was reached is there, (iv) there is not decision of a higher court, or (v) there is no change in the statutory provisions of law. A decision reached on particular facts and on consideration of the law prevailing at that time can be deviated from if some new facts are brought on record or some more cases of higher courts on the subject have come to its notice. It would be justified and indeed under a duty to take a view commensurate to the new development and also because each year and each assessee is a separate year and a separate assessee and the principle of res judicata and estoppels did not apply to income tax proceedings even though the department is once and also because in the earlier order some of the decisions of Supreme Court and the High Courts were not considered." 28. In this view of the matter and for the reasons given above we are of the considered view that the tax payable by the company Under Section 115-O on the amount of dividend declared, distributed or paid is not the tax paid for and on behalf of the shareholder on the dividend income received by the shareholder, and consequently the dividend income received by the shareholder has not suffered any tax in his hands because of tax paid by the company Under Section 115-O on the amount of dividend declared, distributed or paid. We therefore hold that the dividend income received by the shareholder is in fact does not form part of assessee's total income and exempt from tax by virtue of the provisions contained in Section 10(33) of the Act and as such expenditure incurred in relation thereto cannot be allowed as deduction from other taxable income.

29. The second issue made out by the learned counsel is that when the shares were purchased and the assessee assessee's total income chargeable to tax. It became non includible only w. e. f. AY 1998-99 and since the expenditure was incurred for earning taxable income at that the time, it would not change its character by subsequent event.

We do not find any force in this contention of the assessee as well, firstly, because the interest liability is recurring liability of the expenditure of revenue nature from year to year starting from the date of acquisition of shares onwards. See in this case of decision in the case of Challapalli Sugars Ltd. 98-ITR167 (SC). In the case of Tuticorin Alkali Chemicals and Fertilizers Ltd. (supra), the Supreme Court held

that in order to earn income out of the surplus funds, the assessee had invested the amount for the purpose of earning interest and the interest thus earned was clearly of revenue nature and would have to be taxed accordingly. It was further held that the expenditure incurred by the assessee for the purpose of setting up its business could not be allowed as deduction, nor could it be adjusted against any other income under any other head. Similarly any income from a non business source could not be set off against the liability to pay interest on funds borrowed for the purpose of purchase of plant and machinery even before commencement of the business of the assessee.

Their Lordships held that the assessee may be entitled to capitalize the interest payable by it. By what the assessee cannot claim is adjustment of this expenditure against interest assessable Under Section 56. Section 57 of the Act sets out in its Clauses (i) to (iii) the expenditures which are allowable as deduction from income assessable Under Section 56 and it was not the case of the assessee that the interest payable by it on term loans was allowable as deduction Under Section 57(iii) of the Act. The decision in the case of Tuticorin Alkali Chemicals and Fertilizers Ltd. (supra) is an authority for the nature of expenditure upto the date of installation and not thereafter. The interest expenditure could be cost of project until the assessee completes the construction and once it completes the expenditure becomes a running expenditure of revenue nature in the light of the Supreme Court decisions in the cases of Challapalli Sugar Ltd. and Rajendra Prasad Moody (supra) and the provisions of Explanation 8 to Section 43(1) of the Act.

30. The third submission of the assessee that it is saved by proviso to Section 14A prohibiting the re-assessment or enhancement of assessment already completed. The Proviso to Section 14A is inserted by the Finance Act, 2002 with retrospective effect from 11-05-2001 to save certain completed actions otherwise. It reads as under: "Provide that nothing contained in section shall empower the Assessing Officer either to reassess under Section 147 or pass an order enhancing the assessment of reducing a refund already made or otherwise increase the liability of the assessee under Section 154, for any assessment year beginning on or before the 1st day of April, 2001." 31. We can at this stage also look to the

Memorandum explaining the introduction of provisions of Section 14A which reads as under: "The intention of inserting the new section retrospectively was to set the existing controversy on this issue at rest and not to unsettle the cases by raising the issue afresh. It is proposed to insert a proviso to Section 14A so as to clarify that the AO shall not reassess the case under Section 147 or pass an order enhancing the assessment of 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." 32. The Proviso thus clarifies that by applying the provisions of Section 14A of the Act no re-assessment Under Section 147 of the Act or rectification Under Section 154 of the Act shall be made for any assessment year beginning on or before 1st day of April, 2001, in cases where the assessment has already been made meaning thereby not to unsettle the cases by raising the issue fresh by invoking Section 147 or 154 of the Act. But for the Proviso so inserted, the provisions of newly inserted Section 14A with retrospective effect from 1-4-62 could have been applied to already settled cases.

33. In this case an intimation was sent Under Section 143(1) and thereafter when the scrutiny assessment is made Under Section 143(3) it cannot in our opinion be a case of re-assessment or enhancement of assessment. It is making of the assessment itself. Since it is not proceedings Under Section 154 which are opted or resorted to by the AO, it would also not be a case of increasing the liability of the assessee Under Section 154 which are opted or resorted to by the AO, it would also not be a case of increasing the liability of the assessee Under Section 154 as well. The contention is accordingly rejected.

34. The fourth and last contention of the assessee is that the interest expenditure is partly assessable source i.e. when the assessee sells the shares it gives rise to capital gain. This contention, in our opinion, has no force firstly because the interest is not allowable deduction for computing capital gain unless it relates prior to the date of acquisition of shares or bring the shares into existence.

Secondly, because capital gain on the impugned shares does not form part of total income of the assessee until they are sold or transferred. In so far as the year is

concerned, nothing has been sold and transferred. Therefore the contention of the assessee cannot be accepted. The decision in the case of Cocanda Bank (supra) is a case where chargeable income was there in existence and the Head of Income under which it was chargeable was said to be not decisive and it was the nature of income earned that was to be seen. Here in the present case the income from dividend is not includible in the total income at all, therefore, the determination of its nature would not arise.

35. In the case of Rajasthan State Warehousing Corporation 242-ITR-450, the assessee derived income from interest, letting out of warehouses and administrative charges for procurement of food grains while working for the Food Corporation of India as well as the State Government. It claimed deduction of certain expenditure Under Section 37 of the Act in computing its income under the head "Profits and gains of business of profession". The ITO allowed only so much of the expenditure as could be allocated to the taxable income and disallowed the rest of it which was referable to the non taxable income which was exempt Under Section 10(29) of the Act. On appeal, Supreme Court held that income from various ventures was earned in the course of "one indivisible business", the impugned order upholding the apportionment of the expenditure and allowing deduction of only that proportion of it which was referable to the taxable income, was unsustainable. This decision, in our opinion, would be of no help to the assessee after the introduction of Section 14A of the Act.

36. Even otherwise there is no such situation in the present case. The assessee had made investment in shares out of the borrowed money not for carrying on any business. There is no question of any indivisibility of various sources of income by the assessee. The interest paid by the assessee on such borrowed capital which has been invested in shares, is to be allowed as a revenue expenditure Under Section 57 in view of the Supreme Court decision in the case of Rajendra Prasad Moody (supra). There is no other source of income in so far as these borrowings and shares are concerned. The possibility of earning the income by way of capital gain on sale of shares in future may not be of any help to the assessee, in advancing the contention that it was of indivisible source of income and therefore the expenditure could be allowable while computing the capital gain on sale of said

shares. The expenditure of interest on borrowed capital upto the date of sale or upto the date of purchase of shares could at best be said to be capital expenditure and can be allowed as a deduction while computing the income from capital gains in the year of sale but once the shares have been acquired, the interest pertaining to the period after acquisition would be revenue expenditure and allowable Under Section 57 of the Act while computing the income of the assessee from dividend in view of the decision of the Supreme Court in the case of Rajendra Prasad Moody (supra). In these circumstances, the expenditure would not be allowable at all to the assessee even while computing the income under the head "capital gains" and on the theory of "indivisibility of source of income" as contended by the learned counsel of the assessee.

37. in view above we do not find any merits in this appeal.

Accordingly, the appeal is dismissed.

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