IN THE INCOME TAX APPELLATE TRIBUNAL
"E" BENCH, MUMBAI

BEFORE SHRI KULDIP SINGH, JM &
MS PADMAVATHY S, AM

I.T.A. No. 3020/Mum/2023
(Assessment Year: 2017-18)

Edelweiss Asset Management Ltd. 10th Floor, Edelweiss House, Off CST Road, Kalina Santacruz East, Mumbai-400098. **PAN : AABCE8255H**	Vs.	**ACIT, Circle-3(1)(2)** 607, 2nd Floor, Aayakar Bhavan, M.K. Road, Mumbai-400020
Appellant)	:	**Respondent)**

Appellant/Assessee by	:	Shri Dhanesh Bafna a/w Ms. Hinal Shah, Ms. Hirali Desai& Sh. Hardik Nirmal, AR
Revenue/Respondent by	:	Shri P.D. Chougule , Sr. DR
Date of Hearing	:	18.12.2023
Date of Pronouncement	:	19.12.2023

O R D E R

Per Padmavathy S, AM:

This appeal is against the order of the Commissioner of Income Tax, Appeals, / National Faceless Appeal Centre dated 30.06.2023 for the AY 2017-18. The assessee raised the following grounds:

"Each of the grounds and/ or sub grounds of the appeal are independent and without prejudice to the other:

General

1. On the facts and in the circumstances of the case, the order passed by the learned Commissioner of Income-tax (Appeals) National Faceless Appeal Centre (Ld. CIT(A)-NPAC), is contrary and facts and law, beyond jurisdiction and accordingly, is liable to be set aside.

The Appellant prays that the order of the Ld. NFAC be declared as bad-in-law and be quashed.

Disallowance of Employees Stock Option Plan (ESOP) expenditure:

On the facts and circumstance of case and in law, the Ld. CIT(A) NFAC erred in exceeding its Jurisdiction under section 25t of the Income-tax Act, 1961 ('Act') while enhancing the income/reducing the loss of the Appellant to the extent of ESOP expenditure of Rs. 2,04,91,503/-

Without Prejudice to Ground No.2,

3. On the facts and in the circumstances of the case and in law, the Ld. CIT(A)-NFAC erred in bolding that ESOP expenses of the Appellant amounting to Rs. 2,04,91,503/- was not allowable as a business expenditure under section 37(1) of the Act and treating as capital expenditure.

The Appellant prays that its claim be allowed as business expenditure under the provisions of the Act.

Disallowance under section 14A of the Act:

4. On the facts and in the circumstances of the case and in law, the Ld. NFAC erred in upholding the action of the Assistant Commissioner of Income-tax, Circle 3(1)(2), Mumbai ('Ld. AO') in disallowing an amount of Rs. 6,30.553 under section 14A of the Act r.w.r. 8D of the Income-tax Rules, 1962 (the Rules')

The Appellant prays that the disallowance made under section 144 of the Act be deleted.

Initiating penalty under section 270A of the Act:

5. On the facts and in the circumstances of the case and in law, the Ld. AO erred in initiating penalty proceedings under section 270A of the Act.

The Appellant craves leave to add, alter, amend, substitute or withdraw all or any of the Grounds of Appeal herein and to submit such statements, documents and papers as may be considered necessary either at or before the appeal hearing so as to enable the Hon'ble Tribunal members to decide these according to the law."

2. The assessee is a limited company engaged in the business of investment managing services to mutual funds. The assessee for the AY 2017-18 filed the return of income on 21.09.2017 declaring a loss of Rs. 8,64,09,139/- under the normal provisions of the Income Tax Act, 1961 (The Act) and a loss of Rs. 6,58,19,849/- under section 115JB of the Act. The assessee subsequently filed a revised return on 07.03.2019 declaring a total loss of Rs. 10,69,00,642/- under the normal provisions of the Act and the book loss of Rs. 6,58,19,849/- under section 115JB of the Act. The case was selected for scrutiny and the statutory notices were duly served on the assessee. The Assessing Officer (AO) completed the assessment under section 143(3) of the Act wherein he has made a disallowance of Rs.6,30,553/- under section 14A of the Act. In the assessment order, the AO while computing the assessed income had taken the loss as per the original return of income and made the addition towards disallowance under section 14A of the Act. The AO however had considered the loss filed by the assessee as per the revised return of income in the computation sheet i.e. the AO has assessed the income at Rs.10,62,70,089 (refer page 2 of the computation sheet).

3. Aggrieved, the assessee filed the appeal before the CIT(A). In the said appeal, the assessee had raised grounds with regard to the AO having erroneously considering the loss as per the original return of income instead of the loss as per

the revised return of income. The assessee also made a submission before the CIT(A) that the assessee has filed a letter dated 27.02.2020 requesting the AO to rectify the above mistake by passing an order under section 154 and prayed for a direction from the CIT(A) in this regard.

4. The CIT(A) with regard to disallowance under section 14A upheld the order of the AO. While considering the plea of the assessee to direct the AO to consider the loss as per the revised return of income, the CIT(A) noticed that the loss is enhanced in the revised return due to the claim of Employee Stock Option Plan (ESOP) expenses claimed as a deduction by the assessee. The CIT(A) invoked the powers vested by provisions of section 251(1)(a) r.w. Explanation sent enhancement notice asking the assessee to explain why the ESOP of expenses should not be disallowed. The assessee submitted that the amount claimed as ESOP expenses is arising out of the difference between the market value and offer price on the date of exercise in respect of shares offered to employees under the ESOP scheme. The assessee further submitted that the difference is taxed as perquisite in the hands of employees on which tax is deducted. The assessee therefore, submitted that the expenditure on ESOP is eligible for deduction under section 37(1) of the Act. The assessee also relied on various High Court and Tribunal's decisions wherein ESOP expenses are held to be ascertained liability and allowable under section 37(1) of the Act.

5. The CIT(A) held that the expenditure cannot be claimed as a deduction on the ground that the same is tax as perquisite subject to TDS in the hands of the employees. The CIT(A) further held that the expenditure claimed is only a loss of capital that could have been earned by the assessee had the shares being sold in the open market and therefore is capital in nature. The CIT(A) also held that

though various High Courts and Tribunals have taken favourable view towards the assessee on this issue, the appeal is still pending before the Hon'ble Supreme Court and therefore, the issue had not reach finality. Accordingly, the CIT(A) disallowed the expenditure incurred towards ESOP expenses and enhance to the addition in the appellate order. Aggrieved, the assessee is in appeal before the Tribunal.

6. **Ground No.1** is general and does not warrant a separate adjudication. **Ground No.2** is with regard to the jurisdiction of the CIT(A) by enhancing the income / reducing the loss of the assessee to the extent of ESOP expenses. The ld. AR in this regard submitted that this issue of ESOP expenditure was never there before the AO and the CIT(A) is not correct in making the disallowance through a new source of income which is outside the jurisdiction of the CIT(A) under section 251of the Act. The ld. AR submitted that the issue contended before the CIT(A) was for the limited purpose of giving a direction to the AO to consider the loss as per the revised return which is erroneously missed by the AO while passing the assessment order. Therefore, the ld. AR submitted that the CIT(A) has acted beyond his jurisdiction while making the disallowance of ESOP Expenditure, the ld. AR also submitted that the CIT(A) has not just enhanced the income of the assessee in the appellate order but has added a new source of income which is not permissible under the law. The ld. AR relied on the decision of the Hon'ble Supreme Court of India in the case of CIT Vs. Rai Bahadur Hardutroy Motilal Chamaria (1967) 66 ITR 443(SC) wherein it is held that "*the principle that emerges as a result of authorities of this Court is that the appellate Asst. Commissioner has no jurisdiction under section 31(3) of the Act to assess a source of income which has not been processed by the Income Tax Officer and which is not disclosed either in the returns filed by the assessee or*

in the assessment order and therefore, the appellate Asst. Commissioner cannot travel beyond the subject matter of the assessment. In other words the power of enhancement under section 31(3) of the Act is restricted to the subject matter of assessment or the source of income which have been considered expressly or by clear implications by the Income Tax Officer from the point of view of the taxability of the assessee". The ld. AR also relied on the decision of the Kolkata Bench of the Tribunal in the case of Apeejay Shipping Ltd. Vs. ACIT (2023) 152 taxmann.com 298 (Kol. Trib.) in which a similar view has been expressed by the Tribunal.

7. On merits the ld. AR submitted that the ESOP expenditure is an allowable claim under section 37(1) of the Act and in this regard relied on the decision of the Karnataka High Court in the case of CIT Vs. Biocon Ltd. Accordingly, the ld. AR made a without prejudice submission that even on merits the ESOP expenditure is an allowable claim and this fact has been admitted by the CIT(A) himself in the appellate order.

8. The ld. DR on the other hand relied on the order of the lower authorities.

9. We have heard the parties and perused the material on record. Before proceedings we recapitulate the facts pertaining to the issue under consideration. The assessee filed the original return of income declaring a loss of Rs. 8,64,09,139/- which was subsequently revised vide revised return filed on 07.03.2019 to Rs. 10,69,00,642/-. The increase in the returned loss is due to the claim of ESOP expenses in the revised return by the assessee to the tune of Rs.2,04,91,503/-. The said claim has been disallowed by the CIT(A) in appellate proceedings by invoking the powers to enhance under section 251(1)(a).

Therefore it is relevant here to look at the provisions of Section 251 which is extracted below –

> ***Powers of the Commissioner (Appeals)***.
>
> [51]***251.*** *(1) In disposing of an appeal, the Commissioner (Appeals) shall have the following powers—*
>
> *(a) in an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment;*
>
> *(aa)* ***
>
> *(b)* ***
>
> *(c)* ****
>
> *(2) The Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.*
>
> *Explanation.—In disposing of an appeal, the Commissioner (Appeals) may consider and decide any matter arising out of the proceedings in which the order appealed against was passed, notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.*

10. The power of the CIT(A) to enhance has been a subject matter of debate before Hon'ble Supreme Court, various High Courts and Tribunals where the issue has been held for as well as against the assessee considering the facts and circumstances specific to the case. We notice that the Hon'ble Delhi High Court in the case of Gurinder Mohan Singh Nindrajog v/s CIT [2012] 18 taxmann.com 176 (Delhi), while considering the issue of power of CIT(A) to enhance, has held that –

> *14. We have considered the submissions of both the parties. There is no doubt about the fact th while framing the assessment even under Section 143(3) of the Act, the Assessing Officer may omit to make certain additions of income or omit to disallow certain claims which are not admission under the provisions of the Act thereby leading to escapement of income. The Income-Tax A provides for remedial measures which can be taken under these circumstances. While framing assessment under Section 143(3) of the Act, any of the following situation may occur:-*
>
> *(a) The Assessing Officer may accept the return of income without making any addition disallowance; or*

(b) The assessment is framed and the Assessing Officer makes certain addition or disallowance and in making such additions or disallowances, he deals with such item or items of income in the body of order of assessment but he under-assessed such sums; or

(c) He makes no addition in respect of some of the items, though in the course of hearing before him holds a discussion of such items of income

(d) Yet, there can be another situation where the Assessing Officer inadvertently omits to tax amount which ought to have been taxed and in respect of which he does not make a enquiry.

(e) Further another situation may arise, where an item or items of income or expenditure incurred and claimed is not at all considered and an assessment is framed, as a res thereof, a prejudice is caused to the revenue, or

(f) Where an item of income which ought to have been taxed remained untaxed, and there is escapement of income, as a result of the assessee's failure to disclose fully and truly material facts necessary for computation of income.

To ensure for each of such situations, an income which ought to have been taxed and remain untaxed, the legislature has provided different remedial measures as are contained in section 251(1)(a), 263, 154 and 147 of the Act. In the category stated in (a), obviously if an income escapes an assessment, the provisions Section 147 of the Act can be invoked, subject to the condition stated in the proviso of the s section. ***In the category of cases falling in category (b), section 251(1)(a) provides the CIT(A) could enhance such an assessment qua the under-assessed sum i.e. where the AO had dealt the issue the assessment and was the subject matter of appeal.*** *In category falling in (c) & (e), the CIT h been empowered to take an appropriate action under section 263 of the Act In category of case falling under clause (d) and (f), appropriate action under section 147 of the Act can be taken to t the income which has escaped assessment or had remained to be taxed. There can be situation where an item has been dealt with in the body of the order of assessment and the assessee be aggrieved from the addition or disallowances so made, had preferred an appeal before the CIT against the said addition and disallowance, the said disallowance and addition being the subject matter of appeal before the CIT(A) in such cases, the CIT(A) has been empowered u/s 251(1)(a) the Act, to enhance such an income where the Assessing Officer had proceeded to make addition or disallowance by dealing with the same in the body of order of assessment by under assess the same as the same was the subject matter of the*

appeal as per the grounds of the app raised before him. In other words, the CIT(A) has a power of enhancement in respect of such item or items of income which has been dealt with in the body of the order of the assessment, a arose for his consideration as per the grounds of appeal raised before him, being the subj matter of appeal.

15. This is succinctly stated in CIT v. Edward Keventer (Successors) (P.) Ltd. [1980] 123 ITR 200 (Delhi)

16. The only question is as to whether the CIT(A), in exercise of power under Section 251(1)(a) the Act has the power to enhance the assessment in the manner done in the instant case. noted above, the submission of learned counsel for the appellant was that the Assessing Office had not dealt with the issue in question (on which additions are made) in the assessment order all and therefore, the CIT(A) had no power to make any additions under Section 251(1)(a) of the Act. According to the assessee, even if the Assessing Officer might have discussed such an issue during the course of hearing before him, i.e. incidental or collateral examination, that itself would not have given power to the CIT(A) unless the issue was specifically dealt with by the AO in t body of the order of the assessment. It is this aspect which needs consideration in the present case.

(*emphasis supplied)*

11. When we consider the provisions of section 251 and the above judicial pronouncements, certain principles emerge as to that the power to enhance is restricted to the subject matter of assessment or the source of income which have been considered expressly or by clear implications by the AO from the point of view of the taxability of the assessee. In other words the CIT(A) can exercise the power to enhance under section 251(1) in a case where the AO has considered a particular issue of disallowance or addition and while doing so has under assessed the income of the assessee. In cases where the AO has not dealt with the issue at and has not applied his mind on the taxability or non-taxability of a certain matter then the CIT(A) has no jurisdiction to enhance under section 251(1) but should resort to alternate course of action either under section 263 or 147 or 154 as the case may be. The Hon'ble Supreme Court in the case of Rai Bahadur Hardutroy Motilal Chamaria (supra) held that powers of enhancement

conferred on the appellate authority extends only to matters considered by the Income-tax Officer. Therefore it becomes important to analyse whether the AO has considered the issue but has determined" in the course of assessment by deciding not to make any addition/disallowance on that account thereby empowering the CIT(A) to invoke the provisions in respect of enhancement under section 251 of the Act.

12. In the given case, from the perusal of the assessment order we notice that the AO has not recorded the fact that the assessee has filed a revised return anywhere in the assessment order. In body of the assessment order where the AO has determined the assessed income, it is the loss as per the original return of income that has been considered by the AO and not the loss as per revised return. It is not the case where the revised return is filed beyond the time limit under section 139(5) for the AO to ignore the revised return since the assessee has filed the revised return on 17.03.2019 which is well within the time limit. The AO considering the loss as per revised return in the computation, in our view cannot be a reason to argue that the AO has under assessed the income after considering the issue of allowability of ESOP expenses. Given this, in assessee's case the CIT(A) has decided the issue of allowability of ESOP expenses which has not earlier been considered by the AO. In this regard we notice that the Hon'ble High Court of Delhi in the case of CIT v. Sardari Lal & Co. [2002] 120 Taxman 595/[2001] 251 ITR 864 has considered a similar issue wherein it is held that –

> *"the inevitable conclusion is that whenever the question of taxability of income from a new source of income is concerned, which had not been considered by the Assessee Officer, the jurisdiction to deal with the same in appropriate cases may be dealt with under section 147/148 and section 263, if requisite conditions are fulfilled. It is inconceivable that in the presence of such specific provisions, a similar power is available to the first appellate authority."*

13. Taking into consideration the ratio laid down by the above judicial pronouncements and the facts of the present case we are of the view that the CIT(A) has acted beyond his jurisdiction enhancing the income of the assessee by disallowing the ESOP expenses for the reason that the AO while completing the assessment has not taken into consideration the revised return of income and has not examined the taxability of ESOP expenses which the assessee has claimed in the revised return of income. While holding so we would like to add that the decision is based on the facts unique to the assessee's case. This ground of the assessee is allowed accordingly.

14. On merits the issue of allowability of ESOP expenses is covered by the decision of the Karnataka High Court in the case of Biocon Ltd (supra) where it is held that expenditure on account of ESOP is a revenue expenditure and had to be allowed as deduction while computing income. The Special Bench whose order is affirmed by the Hon'ble High Court held that the sole object of issuing shares to employees at a discounted premium is to compensate them for the continuity of their services to the company. By no stretch of imagination, we can describe such discount as either a short capital receipt or a capital expenditure. It is nothing but the employees cost incurred by the company. The substance of this transaction is disbursing compensation to the employees for their services, for which the form of issuing shares at a discounted premium is adopted. Respectfully following the above decision we hold that the addition made towards disallowance of ESOP expenses is not tenable on merits also. **Ground No.3** raised by the assessee in this regard is allowed.

15. **Ground No.4** is with regard to disallowance under section 14A of the Act. During the course of assessment proceedings, the AO noticed that the

assessee has claimed exempt income of Rs. 9,15,629/- and that no disallowance of any expenditure attributable to earning of such income is claimed. Accordingly, the AO invoked the provisions of section 14A r.w.r. 8D and called on the assessee to submit the details of the exempt income earned and supporting evidences as to why the disallowance under section 14A should not be made. The assessee submitted before the AO that the assessee has not actually earned any exempt income during the year under consideration and the impugned income is arising out of consolidation of certain mutual funds which is not regarded as transfer as per section 47(xviii). The assessee filed a note before the AO in this regard which is extracted below:

> *"During the year under concern 'Edelweiss Emerging Leaders Fund was consolidated into 'Edelweiss Mid and Small Cap Fund' further, Edelweiss Equity Savings Advantage Fund - Direct Plan Growth Option- ISIN: INF754K01DE8 was consolidated into 'Edelweiss Equity Savings Advantage Fund Direct Plan Growth-ISIN: INF843K01KCB', The gain arising till the date of consolidation is shown under exempt income by the assessee in the return of income in absence of any specific field available in the return to reflect such a transaction.*
>
> *As per Finance Act 2015, any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating scheme of a mutual fund, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated scheme of the mutual fund in not regarded as transfer as per section 47 clause (xviii).*
>
> *Accordingly, the above transaction of consolidation is not a transfer in the eyes of law and accordingly is not a taxable event and therefore the assessee has not earned any exempt income during the year and has merely disclosed the above transaction in the return of income out of abundant caution.*
>
> *In absence of exempt income, the assessee submits that it has not incurred any expenditure for earning exempt income and accordingly the provision of section 14A of the IT Act are not applicable to the assessee."*

16. The AO did not consider this submission of the assessee and proceeded to make a disallowance of Rs. 6,30,553/- under section 14A of the Act. On further appeal, the CIT(A) upheld the decision of the AO. Aggrieved, the assessee is in appeal before the Tribunal.

17. The ld. AR submitted that the income which is shown by the assessee as exempt is in reality is not an exempt income in order to invoke the provisions of section 14A. The ld. AR further submitted that the income has arisen out of consolidation of certain mutual funds of the assessee and since the same is not considered as a transfer under section 47, the assessee had claimed the income as exempt. The ld. AR also submitted that this fact has been submitted before the AO which has not been considered. The ld. AR drew our attention to the submissions made before the CIT(A) explaining the details of the income treated as exempt as extracted below from which it would be clear that the impugned income is arising out of consolidation of mutual funds which is not taxable under the Act and not an income treated as exempt under the Act in order to invoke the provisions of section 14A of the Act.

Sr. No.	Original investment (i.e. consolidating mutual funds)	Resulting investment (i.e. consolidating mutual funds)	Net Asset Value on the date of consolidation	Cost acquisition	Increase in NAV
1	Edelweiss Equity Savings Advantage Fund- Direct Plan Growth	Edelweiss Equity Savings Advantage Fund- Direct Plan Growth	4,40,226	4,16,281	23,945
2	Edelweiss Equity Savings Advantage Fund- Direct Plan Growth	Edelweiss Equity Savings Advantage Fund- Direct Plan Growth	26,79,834	26,01,758	78,076
3	Edelweiss Equity Savings Advantage Fund- Direct Plan Growth	Edelweiss Equity Savings Advantage Fund- Direct Plan Growth	63,07,246	54,93,638	8,13,608
4	**Total**		**94,27,306**	**85,11,607**	**9,15,629**

18. The ld AR also submitted that when there is no exempt income earned by the assessee, the provisions of section 14A cannot be invoked. The ld. AR drew our attention to the decision of the Hon'ble Delhi High Court in the case of PCIT Vs. Era Infrastructure India Ltd. (2022) 141 taxmann.com 289 (Del.) where it is held that the explanation to section 14A inserted w.e.f.01.04.2022 is prospective to submit that for the year under consideration the explanation to section 14A is not applicable. Accordingly the ld AR submitted that since there is no exempt income earned by the assessee during the year under consideration, the lower authorities are not correct in invoking the provisions of section 14A.

19. The ld. DR on the other hand, submitted that the assessee has made large investments in mutual funds and therefore, the claim that no expenses is incurred towards earning exempt income is not correct. Accordingly, the ld. DR supported the order of the lower authorities.

20. We have heard the parties and perused the material on record. From the perusal of records we notice that during the year under consideration, the assessee in the statement of income has shown an amount of Rs. 9,15,629/- as not taxable under the head Long Term Capital Gains (page 7 of PB). Further from the note submitted before the AO and break up submitted before the CIT(A), the income is claimed as not taxable under the head Long Term Capital Gains for the reason that the transaction of consolidation of mutual funds is not considered as transfer under section 47(xviii). Section 14A provides that 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. Therefore for invoking section 14A the impugned transaction should first result in an income which as per other provisions of the Act is exempt. In the given case the

transaction of the consolidation of mutual funds is not considered as a transfer under section 47(xviii) and therefore it does not result in any income within the definition of section 2(24) of the Act. Therefore we see merit in the contention that the assessee has not earned any income that is exempt under the Act in order invoke section 14A.

21. The Hon'ble Delhi High Court in the case of Era Infrastructure India Ltd (supra) has held that the explanation to section 14A which is inserted w.e.f.01.04.2022 is prospective in nature. Therefore for the year under consideration where the assessee has not earned any exempt income, the explanation to section 14A is not applicable. In view of these discussions and considering the facts of the present case, we hold that the AO is not correct in invoking the provisions of section 14A and accordingly the disallowance made in this regard is to be deleted. This ground is allowed in favour of the assessee.

22. **Ground No.5** is consequential and does not warrant a separate adjudication.

23. In the result, appeal of the assessee is allowed.

Order pronounced in the open court on 19-12-2023.

Sd/-	***Sd/-***
(KULDIP SINGH)	**(MS. PADMAVATHY S)**
Judicial Member	**Accountant Member**

**SK, Sr. PS*

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent
3. DR, ITAT, Mumbai
4. Guard File
5. CIT

BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai