

IN THE INCOME TAX APPELLATE TRIBUNAL, “C” BENCH, KOLKATA

Before : **Shri P.M.Jagtap, Accountant Member and
Shri S.S. Viswanethra Ravi, Judicial Member**

I.T.A No. 2123/Kol/2013

A.Y. 2006-07

D.C.I.T,
Cir-10, Kolkata
(Appellant)

Vs

M/s Phillips Carbon Black Ltd
PAN: AABCP5762E
(Respondent)

I.T.A No. 2124/Kol/2013

A.Y. 2008-09

D.C.I.T, Cir-10,
Cir-10, Kolkata
(Appellant)

Vs

M/s Phillips Carbon Black Ltd
PAN: AABCP5762E
(Respondent)

CO No: 30/Kol/2014

[ITA No. 2124/Kol/2013]

A.Y. 2008-09

M/s Phillips Carbon Black Ltd
PAN: AABCP5762E
(Cross Objector)

Vs.

D.C.I.T,
Cir-10, Kolkata
(Respondent)

For Revenue : Shri Kalyan Nath, JCIT, Sr.DR
For Assessee : Shri D.S.Damle, FCA, Id.AR

Date of Hearing: 16-06-2016

Date of Pronouncement: 12 -08-2016

ORDER

SHRI S.S. VISWANETHRA RAVI, JM

Two appeals in **I.T.A No. 2123/Kol/2013** and **I.T.A No. 2124/Kol/2013** by Revenue A.Ys 2006-07 and 2008-09 respectively and **CO No. 30/Kol/2014** by the Assessee for AY 2008-09 are directed against the separate orders of the CIT(Appeals)-XII, Kolkata dt:15-03-2013/13-03-2013.

2. Since the issues involved in these appeals and cross objections are common, therefore, heard together with the consent of the both the parties and disposed of the same by a consolidated order for the sake of convenience.

3. First we take up ITA No.2123/Kol/2013 A.Y 2006-07 filed by the revenue

4. Ground no.1 raised by is as under:-

1. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that Rs.1,22,89,710/- was not allowable disallowance u/s 14A on the basis of Hon'ble ITAT, Kolkata's decision in assessee's own case for Asst Year 2004-05 when the issue of application of Rule 8D as notified on amendment in March, 2008 is procedural nature as per decision of the Hon'ble Supreme Court in the cases vide (2000) 247 ITR 586 (SC) ?

5. Brief facts of this issue are that the assessee is a company engaged in the business of manufacture and sale of carbon black and generation and sale of power. The assessee filed its return on 30-11-06 declaring a loss of Rs.16,20,03,209/-. The said return was processed determining at loss. Thereafter, on scrutiny the notices u/s. 143(2)/142(1) were issued. In response to which, the Id.A/Rs of the assessee appeared and submitted all the details including the books of accounts and information as called for before the AO. During the assessment proceedings u/s. 143(3) the AO found that the assessee has

earned dividend income of Rs.11,400/- and interest on tax free 6.75% US 64 Bonds of Rs. 1,17,565/-, which was claimed as exempt from tax u/s. 10. The assessee in its computation of income has stated that no expenses were incurred for earning the exempt income and submitted no deduction shall be allowed in respect of any expenditure incurred by the assessee in relation to earning income, which was not form part of the total income.

6. The AO was of the view that Rule 8D in all proceedings pending on the date of notification and contention of the assessee was rejected. The AO, based on Rule 8D worked out the disallowance of expenditure including interest as under:-

(A)	Interest Debited to P & L Account		Rs.3064.97 lacs
(B)	Opening Investments as on 01.04.2005		Rs.2035.95 lacs
	Closing Investments as on 31.03.2006		Rs.2906.53 lacs
	Therefore, Average Investments		Rs.2471.24 lacs
(C)	Total Assets (Rs. Lacs)	As on 31/3/06	As on 1/4/05
	Fixed Assets	28219.99	29805.34
	Investments	2906.53	2035.95
	Current Assets, Loans & Advances	39177.06	34593.78
	Miscellaneous Expenditure	<u>129.37</u>	<u>143.83</u>
	Total	<u>70432.95</u>	<u>66578.90</u>
	Therefore, Average Total Assets		Rs. 68505.92 lacs
	Amount disallowable as per Rule 8D(2)(ii) (AxB)/C		Rs. 110.56 lacs
	Amount disallowable as per Rule 8D(2)(iii) 0.5% of B		Rs. 12.35 lacs
	Therefore, Total Amount disallowable u/s. 14 r.w.r 8D		Rs.122.91 lacs
	i.e.		Rs.1,22,91,000/-

7. On first appeal, the CIT-A relying on the decision of the Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd Vs. CIT reported in 328 ITR 81, wherein it held that Rule 8D notified by the Board on 24-03-2008 did not have

retrospective application but the Rule was applicable only prospectively and therefore applicable from A.Y 2008-09. The CIT-A following his earlier order dated 28.03.2012 and the orders of the ITAT Kolkata in the cases of Civil Engineers Enterprises P.Ltd Vs. DCIT (ITA No. 859/Kol/2010 and ITO Vs. B.P.S Securities P.Ltd (ITA No.123/Kol/2010) on similar issue directed the AO to restrict the same u/s. 14A to 1% holding that disallowances of interest of Rs.110.56 lacs made under Rule 8D(2)(ii) and expenses of Rs.12.35 lacs made under Rule 8D(2)(iii) was arbitrary and bad and is liable to be deleted.

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8. Aggrieved by such order of the CIT-A now the revenue before the Tribunal by aforementioned ground.

9. At the time of hearing before us, both the parties argued that the issue involved in this appeal is squarely covered by the order dated 27-05-2011 of the Third Member, ITAT, Kolkata, wherein the ITAT, Kolkata vide its order dated 10-06-2011 in ITA No.566/Kol/2009 & CO 39/K/09 for the AY 2004-05 in assessee's own case has held as under page 2 & 10 of the paper book.

10. Heard and perused the record. The Hon'ble Third Member in assessee's own case for AY 2004-05 *supra* held that the disallowance of 1% as directed by the CIT-A of the exempt income is fair and reasonable. The order of the Hon'ble Third Member was also followed by the CIT-A-XXIV in assessee's own case for the AY 2007-08. Further, the ITAT Kolkata Benches in its orders dated 19-08-2010 in the following cases has held that 1% of the exempt income is fair and reasonable for the purpose of making disallowance u/s.14A, the relevant portion of which is reproduced as under:

“Since there was a difference of opinion between the Id. Members constituting the Division Bench of ITAT, Kolkata with regard to the following question, the matter was referred to Third member under section 255(4) of the I.T Act, 1961 for his opinion:-

“Whether in the facts and circumstances of the case, the disallowance of Rs. 2 lakhs on ad hoc basis proposed by Id. JM or disallowance of expenses to 1% of the total exempted income proposed by Id.AM is justified under section 14A of the I.T Act, 1961.”

2. *Hon’ble President, ITAT nominated Shri G.D Agarwa, Hon’ble Vice President (AZ)KZ) as Third Member. The Hon’ble Third Member vide his order dated 27.05.2011 has concurred with the findings of Id. Accountant Member by observing as under:-*

“7. I have considered the submissions of both the parties and perused the orders proposed by Ld. Members. The dispute in the present reference is in narrow compass. In the assessment order the AO disallowed administrative expenses of Rs.42,130/- u/s. 14A of the Act calculated @1% of the tax-Free income. The Id C.I. T.(A) by applying Rule 8D of the Rules directed the A.O. to disallow Rs.10.28.900/-, thereby enhanced the total income by Rs.9,86, 770/-. In the grounds of cross objection the assessee objected to the order of the Id C.I. T (A) only on the issue -of application of Rule 8D for the purposes of making disallowance u/s 14A of the Act. Perusal of the grounds of cross objection showed that the assessee did not challenge the disallowance made by the A.O. at Rs.42,130/-, but objected only to the application of Rule 8D which in its opinion was not applicable for assessment year under consideration, i.e. A. Y 2004-05. I find merit in the submissions of the learned counsel for the assessee that the assessee never challenged the A.O 's order disallowing Rs.42,130/- u/s 14A of the Act but it objected only to the enhancement made by the Id. C.I.T.(A) by resorting to Rule 8D of the Rules. It appeared from the orders proposed by both the Ld. Members that both of them agreed that Rule 8D was not applicable to the assessee's case since the year under appeal was A. y. 2004-05, whereas Rule 8D was applicable prospectively from A. Y. 2008-09. In support of this finding both the Ld. Members relied on the decision of Hon 'ble Bombay High Court in the case of Godrej & Boyce Manufacturing Co. Ltd (supra). Therefore, once both the Ld. Members agreed with the . Submissions of the learned for the assessee-that Rule 8D of the Rules was not applicable and disallowance u/s. 14A of the Act could not be made with reference to said Rule 8D in assessment year 2005-06, then the question remains whether it was open

for the Tribunal to estimate amount disallowable on any basis other than the basis adopted by the A.O. The assessee in its cross objection did not per se challenge the disallowance made by the A.O u/s. 14A of the Act in the assessment order but only objected to the enhancement of disallowance by the Id. C.I.T. (A) by reference to Rule 8D of the Rules. Once both the Ld. Members agreed that Rule 8b was not applicable to the assessee's case for assessment year 2004-05, then the direction of the Id. C.I.T.(A) for making disallowance as per Rule 8D was required to be vacated. Since the assessee did not challenge the order of the A.O making the disallowance u/s. 14A calculating the amount disallowable @ 1% of the total exempt income, then it was not open for the Tribunal to go into the question of quantification of amount disallowable, because neither the assessee nor the revenue had challenged the estimation of amount disallowable, as made by the A.O. in the assessment order. In these circumstances, the Tribunal cannot go into the question of reasonableness of the estimate of the amount disallowable made by the A.O. because neither the assessee nor the revenue had challenged the findings of the A.O. making the disallowance u/s. 14A of the Act at Rs.42,130/- .Considering the totality of the facts and circumstances of the case, I agree with the findings of the Ld. A.M that the amount disallowable u/s. 14A of the Act should have been 1 % of the total exempt income.

8. The matter will now go to the regular Bench for passing the order as per the majority view".

11. In view of the above, in accordance with the majority view, we hold that the expenses at 1% of the total exempt income is reasonable as disallowable u/s. 14A of the Act as held by the Third Member in ITA No. 566/Kol/09 & CO 39/Kol/09 for the A.Y 2004-05 in assessee's own case supra. Therefore,, accordingly, the ground no-1 raised by the Revenue is dismissed.

12. Ground no.2 raised by the revenue is as under:-

2. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs. 85,00,000/- as flying rights charge was allowable business expenditure on the basis of decision of the CIT(A)-XXXIV, Kolkata in assessee's own case for Asst year 2005-06, when the said decision is challenged before the Hon'ble ITAT, Kolkata?

13. Brief facts of this issue are that the AO during the course of assessment proceedings found that the assessee company had incurred aircraft rent amounting to Rs.3,40,00,000/- and the same was claimed as an expenditure in the return. The assessee has made the following submission in support of its claim.

“During the previous year, the assessee incurred flying rights charges of Rs.3,40, 00, 000/- for the aircraft flying rights taken by the assessee from Spencer Travel Services Ltd. The assessee entered into an agreement dated 17.11.03 with M/s Spencer Travel Services Ltd whereby the assessee agreed to take exclusive flying rights of an aircraft being a Beechjet 400 Aircraft. In consideration of the same the assessee also agreed to pay a sum of Rs.340 lacs per annum to M/s Spencer Travel Services Ltd towards flying rights charges.

The assessee company is the largest carbon black manufacturer in the country having manufacturing facilities at Durgapur, Baroda and Cochin. The assessee company also generates power and sells power from its unit at Baroda. The assessee also has offices and warehouses at different locations in the country. The customers are also scattered in different parts of the country and outside. To cater to the business needs of the company the company had decided to take on hire the exclusive flying rights of an aircraft and thus entered into the agreement dated 17.11.03 with M/s Spencer Travel Services Ltd (copy attached). By virtue of the said agreement the assessee was always made available of the aircraft for the flying needs of its senior officials.

If a reference is made to the aforesaid agreement, Spencer Travel Services Ltd was to incur all costs and expenses associated with the operation of the aircraft. The assessee was not required to pay anything over and above the sum of Rs.340 lacs agreed between the parties irrespective of the use of the aircraft. The aircraft flying rights were taken considering the business needs of the assessee and the aircraft was used by very senior officials of the company for the purposes of business and furtherance thereof”.

14. The AO after considering the above submissions of the assessee and following the similar payments made in AY 2005-06 disallowed 25% of the expenditure of Rs.340 lacs, amounting to Rs.85,00,00/- being non-business purpose and added the same to the total income of the assessee.

15. On first appeal, the CIT-A relying on his earlier order dated 30-11-2011 for AY 2005-06 deleted the disallowance 25% of the expenditure incurred on aircraft flying rights charges.

16. Aggrieved by such order of the CIT-A, now the Revenue before the Tribunal by raising by above ground.

17. At the time of hearing before us, the assessee submits that the issue involved in this appeal is squarely covered in favour of the assessee by an order dated 30th October, 2014 of the Hon'ble High Court at Calcutta in GA No. 1382 of 2014 & 2390 of 2014/ITAT 31 of 2014 & 107 of 2014 in assessee's own case for the A.Y 2005-06 placed at pages 36-37 & 51-52 respectively of the assessee's paper book. In this case the revenue preferred appeal before the Hon'ble Calcutta High Court, wherein the revenue's appeal was dismissed by upholding the order dated 13th November, 2013 of the Tribunal in ITA No. 235/Kol/2012 for the AY 2005-06 on similar issue and in ITA No.741/Kol/2012 & 939/K/2012 for AY 2007-08. The Ld. DR conceded that the Hon'ble High Court of Calcutta dismissed their appeal. In view of the same and respectfully following , ground no-2 of revenue's appeal is dismissed.

18. Ground no.3 raised by the revenue is as under:-

3. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs.12,26,700/- as retainer-ship fee was allowable business expenditure when the A.O made the addition on the ground that the track record of the party to render such service was not known ?

19. The AO found that the assessee had made payments of Rs.12,26,700/- to M/s. Sreebala P.Ltd. The assessee has made the following submissions:-

"During the previous year, retainership fees amounting to Rs.12267001- was paid to M/s Sreebala Pvt Ltd. The aforesaid party catered to the customers in the non-tyre segment, which are widely scattered, and are in large numbers, and for which purposes the assessee company appointed Sreebala (P) Ltd as their consultant for market development in the non-tyre segment for sale of carbon black in Eastern India since 1994. The role of the party envisages identification of the customers, procurement of the orders from these customers, coordinating supplies and arranges collection from these parties. The payments to the party have always been made by account payee cheques. The details of payments made to M/s. Sreebala Pvt. Ltd are attached herewith. We also attach herewith copy of the renewal agreement with the aforesaid party."

20. The AO after considering the above submissions of the assessee being similar payments made in AY 2005-06 disallowed the amount of Rs.12,26,700/- for the assessment year under consideration and added back the same to the total income of the assessee.

21. On first appeal, the CIT-A found that the issue of allowability of payment of retainership/consultancy charges paid to M/s. Sreebala P.Ltd came up before the ITAT, Kolkata in assessee's case in a.y 1996-97 and 1997-98. The Tribunal vide its order dated 26-7-04 in ITA Nos. 720 & 747/Kol/03 held that the payments made to M/s. Sreebala P.Ltd were allowable as business expenses. He further found that the Tribunal in assessee's own case for AY 1998-99 in ITA No. 232/K/04 dated 05.05.05 and for AY 1999-2000 in ITA No.1818/K/05 dtd. 30.01.06 followed its earlier order for AY

1996-97 and 1997-98 and allowed the claim of assessee regarding retainership fees paid to M/s. Sree Bala P.Ltd The disallowance in AY 2003-04 and 2004-05 was deleted by the CIT(A). The Tribunal in ITA No.1447/Kol/06 dated 22.09.06 and ITA No.566/K/09 dated 10.06.11 had upheld the orders of the CIT(A) deleting the said disallowance. The CIT-A relying on order of Tribunal and following his earlier orders deleted the disallowance being treating as business expenditure

22. Aggrieved by such order of the CIT(A) now the revenue is in appeal before us by raising the above mentioned ground.

23. At the time of hearing before us, the assessee submits that the issue involved in this ground is squarely covered in favour of assessee and against the revenue by the order of the Hon'ble Calcutta High Court dated 30th October, 2014 in GA No.1382 of 2014/ITAT 31 of 2014, wherein the revenue's appeal was dismissed by upholding the order dated of the Tribunal in ITA No. 235/Kol/2012 for the AY 2005-06. The Ld. DR conceded that the Hon'ble High Court of Calcutta dismissed their appeal. Respectfully following the same, this ground of revenue is dismissed.

24. Ground no.4 raised by Revenue reads as under:-

Whether Ld CIT(A)-XII, Kolkata. was justified in holding that expenditure of Rs. 19,33,576/- as 25/0 of Guest House Expenses was allowable business expenditure on the basis of decision of the Hon'ble ITAT, Kolkata in assessee's own case for Asst year 2000-01 and 2001-02, whereas the Hon'ble Mumbai ITAT in the case of New India Extrusion Ltd -vs- CIT [46 SOT Mum (10 Taxman 165) held the issue in favour of revenue?

25. During the assessment proceedings the AO found that the assessee filed the details of miscellaneous expenses along with Tax Audit Report, wherein it was

observed that the assessee has incurred expenditure on guest house of Rs.77,34,306/-. The AO, that being nature of expenses as was in AY 2005-06, disallowed 25% of the total expenses of Rs.19,33,576/- and added the same to the total income of the assessee.

26. On 1st appeal, the CIT-A following the order dt: 29-07-2005 of Tribunal in ITA 1071/Kol/2005 deleted the said disallowance.

27. Aggrieved by such order of the CIT(A) now the revenue is in appeal before us by raising the above mentioned ground.

28. At the time of hearing before us, the assessee submits that the issue in hand is squarely covered in favour of assessee and against the revenue by the order of the Hon'ble Jurisdictional Calcutta High Court vide order dated 23-02-2012 & 30-10-2014 in GA Nos. 276 of 2012 & ITAT 12 of 2012 & 1382 of 2014/ITAT 31 of 2014 (in ITA No.235/Kol/2012 for the AY 2005-06), wherein the revenue's appeal was dismissed by upholding the order dated 13th November, 2013 of the Tribunal in ITA No. 235/Kol/2012 for the AY 2005-06 on similar issue. The Ld. DR conceded that the Hon'ble High Court of Calcutta dismissed their appeal. Respectfully following the same, this ground of revenue is dismissed.

29. The appeal in ITA No.2123/Kol/2013 filed by the revenue for AY 2006-07 is dismissed as stated above.

Now we shall take up, ITA No.2124/Kol/2013 A.Y 2008-09 filed by the Revenue

30. The Revenue raised following grounds:

1. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs. 85,00,000/- as flying rights charge was allowable business expenditure on the basis of decision of the CIT(A)-XXXIV, Kolkata in assessee's own case for Asst year 2005-06, when the said decision is challenged before the Hon'ble ITAT, Kolkata?

2. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs.12,26,700/- as retainer-ship fee was allowable business expenditure when the A.O made the addition on the ground that the track record of the party to render such service was not known ?

3. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs. 14,12,705/- as 25% of Guest House Expenses was allowable business expenditure on the basis of decision of the Hon'ble ITAT, Kolkata in assessee's own case for Asst year 2000-01 and 2001-02, whereas the Hon'ble Mumbai ITAT in the case of New India Extrusion Ltd -vs- CIT [46 SOT Mum (10 Taxman 165)] held the issue in favour of revenue?

4. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs. 2,91,00,000/- as Licence Fee paid to RPG Enterprise was allowable business expenditure on the basis of decision of the Hon'ble ITAT, Kolkata in assessee's own case for Asst year 2004-05, whereas the Revenue has filed appeal before the Hon'ble ITAT, Kolkata against the CIT(A)'s decision on same issue for Asst year 2004-05 ?

31. Ground nos.1 to 3 raised in ITA No.2124/Kol/2013 for the A.Y 2008-09 by the revenue are identical to that of grounds raised in ITA No.2123/Kol/2013 for the A.Y 2006-07, which have already been disposed of by us by following the decision of the Hon'ble Calcutta High Court in the case of *supra*. Following the views taken by us herein above in ITA No.2123/Kol/2013 for the A.Y 2006-07, the grounds 1 to 3 in ITA No.2124/Kol/2013 for the AY 2008-09 being identical and similar are dismissed.

32. Ground no.4 raised by revenue reads as under:-

4. Whether Ld CIT(A)-XII, Kolkata, was justified in holding that expenditure of Rs. 2,91,00,000/- as Licence Fee paid to RPG Enterprise was allowable business expenditure on the basis of decision of the Hon'ble ITA T, Kolkata in assessee's own case for Asst year 2004-05, whereas the Revenue has filed appeal before the Hon'ble ITAT, kolkata against the CIT(A)'s decision on same issue for Asst year 2004-05 ?

33. During the assessment proceedings the AO found that the assessee has paid license fees of Rs.2,91,00,000/- to RPG Enterprises. The assessee submitted as under:-

"Phillips Carbon Black Ltd is one of the licensee companies of Mls RPG Enterprises Ltd having entered into a licence agreement with them (copy of agreement attached}. As a licensee of RPG Enterprises Ltd, we enjoy various services, as and when required, and the services are provided by RPG Enterprises Ltd (at cost), who have experts employed and/or engaged in various areas of business run on modern lines. In competitive environment, the services are absolutely essential but it is very difficult for the company to employ experts in all fields of business on its own.

As licensee of RPG Enterprises Ltd we enjoy the services of their experts readily, as and when required, though at cost. Major areas where services are provided by RPG Enterprises Ltd include, amongst others,

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|---|------------------------------------|
| <i>(a) Human resources,</i> | <i>(b) Strategic planning</i> |
| <i>(c) Corporate finance,</i> | <i>(d) Management information,</i> |
| <i>(e) Forex management,</i> | <i>(f) Taxation and legal,</i> |
| <i>(g) Total quality management,</i> | <i>(h) Project development,</i> |
| <i>(i) Information technology, (j) Corporate governance, etc.</i> | |

It is with the timely support of such services provided by RPG Enterprises Ltd that the company has become the largest carbon black manufacturer in the country and the largest exporter of carbon black from India. It is also one of most cost efficient production center. The company started its production facility at Durgapur and had further acquired production facilities at Baroda in Gujarat and Cochin in Kerala and substantially expanded the production capacities. With these production facilities in

place the company caters easily to markets in East, West and South India. Needless to mention, that there is a considerable saving that has arisen to the company. It all became possible since it enjoyed the services of experts of RPG Enterprises Ltd readily and timely, though at cost.

The entire business strategy of our company in areas of exports, capacity enhancement, acquisition of capacities in other parts of India for geographical spread to have outposts in the consuming centers are all results of timely and strategic planning done by M/s RPG Enterprises Ltd for us. "

34. The AO found that in past assessments similar payments made to M/s. RPG Enterprises Ltd as licence fees and were disallowed and since the nature of agreement was same in earlier years. The AO disallowed Rs. 2,91,00,000/- and added the same to the total income of the assessee.

35. On first appeal, the CIT-A after considering the various submissions and relying on earlier orders of the ITAT allowed the claim of assessee as deduction.

36. Aggrieved by such order of the CIT-A now the revenue is in appeal before us by raising the above mentioned ground.

37. At the time of hearing before us, the assessee submits that the issue involved in this appeal is squarely covered in favour of assessee and against the revenue by the order of ITAT in ITA No.566/Kol/09 & CO No.39/Kol/09 for the AY 2004-05 and the order of the Hon'ble Calcutta High Court vide order dated 23-02-2012 for the AY 2004-05, wherein the Hon'ble Calcutta High Court has dismissed the revenue's appeal on this issue. The Ld. DR conceded that the Hon'ble High Court of Calcutta dismissed their appeal. Therefore, in view of the same, we dismiss the ground no-4 raised by the Revenue.

38. Therefore, the appeal of the Revenue in ITA No. 2124/Kol/2013 for the AY 2008-09 is dismissed.

C.O No.30/Kol/2014

arising out of ITA No.2124/Kol/2013) AY 2008-09 filed by the assessee.

39. The assessee raised Grounds of Cross-Objection

1. That on the facts and in the circumstances of the case the Commissioner of Income Tax (Appeals) erred in upholding the action of the Assessing Officer in disallowing a part of the interest and other expenses u/s 14A of the Income Tax Act, 1961 read with Rule 8D of the Income Tax Rules, 1962.

2. That on the facts and in the circumstances of the case the Commissioner of Income Tax (Appeals) should have seen that the Assessing Officer without pointing out the mistake in the disallowance offered by the assessee u/s 14A proceeded to invoke Rule 8D(2)(ii) and Rule 8D(2)(iii) for making the disallowance u/s 14A which was not permissible.

3. That on the facts and in the circumstances of the case the Commissioner of Income Tax (Appeals) erred in not deciding the issue of addition of the disallowance made u/s 14A read with Rule 8D to the book profit for the purposes of section 115JB and in holding that the issue is purely academic in nature.

40. Ground no's 1 to 3 relate to upholding the action of the AO by the CIT-A in making disallowances of interest and other expenses u/s. 14A of the Act.

41. During the previous year the assessee earned dividend income of Rs. 1,55,10,976/- and interest of Rs.1,17,565/- on tax-free US 64 Bonds and claimed these as exempt u/s. 10. In response to the query, made to the assessee why management expenses should not be disallowed on pro-rata basis interms of section 14A of the Act.

the AR submitted that the assessee did not incur any expenditure in earning the aforesaid income, which was exempt from tax, except for the sum of Rs.2,22,500/- which the assessee on its own added to the total income. The dividend and interest were received by cheques payable at par and no expenses were incurred even to realize the same. The ARs also submitted that the investments in shares and securities were made out of own funds from time to time and no further expenditure on the same can be attributed to earn the aforesaid income. The A/Rs further stated that against the investments of Rs.28.06 crs held by the assessee as at 31.03.2008, the own fund stood at Rs.242.80 crs which were far in excess of the investments in shares and securities. As such no expenses can be attributed to earning of the exempt income and disallowable u/s 14A of the Act.

The submissions of the assessee are considered. However, the same is not acceptable since the assessee is bound to incur some expenditure for earning the exempt income. In view of the provisions of section 14A read with Rule 8D (inserted by the IT(Fifth Amendment) Rules 2008 w.e.f 24.03.2008), the expenditure incurred for the purpose of earning of exempt dividend income and interest income is computed as under:-

Interest u/s. Rule 8D(2)(ii)

(a) Interest Debited to P & L Account		Rs.1944.70 lacs
(b) Opening Investments as on 01.04.2005		Rs.2805.52 lacs
Closing Investments as on 31.03.2006		Rs.2805.52 lacs
Average Investments		Rs.2471.24 lacs
(c) Total Assets in Rs. Lacs as on	<u>31/3/07</u>	<u>31.03.08</u>
Fixed Assets	28138.09	37541.49
Investments	2805.52	2805.52
Current Assets, Loans & Advances	42934.71	44971.50
Miscellaneous Expenditure	<u>103.23</u>	<u>88.01</u>
Total	<u>73981.55</u>	<u>85406.52</u>

Therefore, average of opening & closing total assets	Rs. 79694.04
Proportionate Interest as per Rule 8D(2)(ii)(axb/c)	Rs.68.46
Proportionate expenses as per Rule 8D(iii) 0.5% of (b)	Rs.14.03
Total as per Rule 8D	Rs.82.50

The assessee itself disallowed a sum of Rs.2,22,500/-, therefore a further disallowance of Rs.80,27,500/- is made u/s. 14A read with Rule 8D and added to total income.

42. Before the CIT-A , the assessee objected to the additions of RS.80,27,500/- being expenses u/s 14A to the computation of Book Profits for the purposes of S.115JB of the Act and challenged the action of AO in invoking Rule 8D to make disallowance u/s 14A of the Act which has been disputed by the appellant and submitted as under:

*It is submitted that the only addition that can be made under clause (f) to the Explanation to section 115JB are "the amount or amounts of **expenditure relatable to any income** to which section 10 (other than the provisions contained in clause (38) thereof) or section 11 or section 12 apply". Under the provisions of section 14A no 'deduction is to be allowed in respect of' **expenditure incurred by the assessee in relation to income** which does not form part of total income under this Act. Since the issue of expenditure related to dividend income, falling under section 10 it is clear that the two provisions are similar in nature. Clause (f) uses the words "**expenditure relatable to any income**", while section 14A uses the words "**expenditure incurred by the assessee in relation to income**". Section 14A contains sub-section (2) and (3) which do not find place in clause (f) of the Explanation to section 115JB. Clause (f) only deals, with the direct expenses incurred in relation to income not forming part of total income. Therefore, insofar as computation of adjusted book profit is concerned, provisions of sub-section (2) and sub-section (3) of section 14A cannot be imported into clause (f) of Explanation to section 115JB. The disallowance of interest of Rs.1,29,10,000/- was made in terms of section 14A(2) read with Rule 8D(2)(ii) and the disallowance of expenses of Rs.14,28,000/- was made in terms of section 14A(2) read with Rule 8D(2) (iii) and the same therefore cannot be added under clause (f) to the Explanation to section 115JB of the Act.*

The appellant submits that the aforesaid view of the appellant also finds support from the decision of the Hon'ble Delhi Bench of the Income Tax Appellate Tribunal in the case of, Goetze (India) Ltd vs. CIT reported in 32 SOT 101. Similar decisions has also been rendered by the Delhi Tribunal in the case of Quippo Telecom Infrastructure Ltd vs. ACIT [ITA No.4931/Del/2010] dated 18.02.2011 and by the: Mumbai Tribunal in the case of Essar Teleholdings Ltd vs. DCIT [ITA No. 38S0/Mum/2010] dated 29.07.2011. In the circumstances it is submitted that no addition of the expenses including interest amounting to Rs.80,27,500/- disallowed u/s 14A by invoking the provisions of Rule 8D in the computation of total income

under the normal provisions of the Act in the assessment order made u/s 143(3) can be made under clause (f) to the Explanation to section 115JB. The appellant therefore submits that the addition of Rs.80,27,500/- made in the computation of book profit for the purposes of section 115JB be deleted.

43. The CIT-A after considering the above submissions of the assessee has disposed of the appeal by observing as under:-

“4. I have considered the finding of the AO in his order dt. 30-04-2010 and the written submission filed by the A.R during the appellate proceeding. Appeal and ground no.1 is against the disallowance of 8027500/- on the basis of calculation under Rule 8D read with sec. 14A of the I.T Act, 1961 for earning the exempt income. The assessee has earned exempted income of Rs.15510976/- and interest income of Rs.117565/- during the relevant assessment year. The AO has calculated expenditure under rule 8D in order to earn the exempted income. The A.R has submitted that the assessee did not incur any expenditure for earning this exempted income. I have considered the finding of the AO and the written submission filed by the A.R. I think after the amendment brought in the Finance Act, 2006 w.e.f 01-04-2007 the word used are “the Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of total income....” From this words of the statue it is clear that the AO has no option, but to determine expenses as per Rule 8D. Accordingly, the AO is justified in calculating the expenses for earning the exempted income and thus, assessee’s appeal on ground no. 1 is dismissed.”

44. Aggrieved by such order of the CIT-A now the assessee before the Tribunal by filing respective ground as mentioned hereinabove.

45. At the time of hearing before us the Ld.AR submits that the Asseesee suo moto disallowed an amount of Rs.2,22,500/- and argued assessee’s own funds are larger than the investments and no part of loan was utilized for investments. Further submitted that the assessee is a promoter of CEAT company and earned exempt income and relied on by the order dated 14-05-2013 of “Ä” bench of Kolkata

Tribunal in the case of DCIT,CC-XXVII, Kolkata Vs. REI Agro Ltd for the AY 2009-10 in ITA No.1811/Kol/2012 wherein held that invocation of Rule 8D of Rule without verifying and correctness of claim of assessee is bad.

46. On the other hand, the Ld. DR submits that the CIT-A discussed the same in page no-16 that the AO can not go beyond Rule 8D and relied on the orders of the authorities below.

47. We have heard the rival submissions and perused the material available on record.

48. The question before us to examine is as to whether the AO rightly invoked Rule 8D without verifying the correctness of claim of assessee in the facts and circumstances of the case.

49. We find from the order of AO that the assessee was holding investment to the tune of Rs..28.06 crores and its own fund standing at Rs.242.80 crores on 31-08-2008 and it is clear from the same that the funds were in surplus than that of investments and the AO did not accept contentions of the assessee. The observation of the AO was that the assessee is bound to incur some expenses in earning the exempt income and thereby he invoked the Rule 8D and computed the expenditure. In our view, without examining the correctness of the claim of assessee and applying Rule 8D thereon on mere presumption that the assessee would have been incurred some expenditure is not permissible under law. It is also noticed, the observation of CIT-A that the AO has no option, but to determine the expenses as per Rule 8D. In this regard, we may refer to the order dt:14-05-13 of ITAT, Kolkata, 'A' Bench, Kolkata

in ITA No.1811/Kol/2012 for the AY 2009-10 in the case of *supra* has disposed of the issue by observing as under:-

” 5. This issue in this appeal of revenue is against the order of CIT(A) deleting the addition made by AO by invoking the provisions of section 14A read with Rule 8D(2)(iii) of the I. T. Rules, 1962. For this, revenue has raised following two grounds:

“3. That on the facts and in the circumstances of the case the CIT(A) has erred in law by deleting the disallowance made u/s. 14A of the Income-tax Act, 1961 read with rule 8D(2)(iii) of the I T Rules.

4. That on the facts in the circumstances of the case the CIT(A) erred in deleting the disallowance made u/s. 14A of the Income-tax Act without appreciating the fact that before proceeding for invoking the provision of section 14A read with Rule 8D(2)(iii) the AO has conducted necessary examination and ground work, which are evident from the recordings of note-sheet.”

6. We have heard rival submissions and gone through facts and circumstances of the case. Brief facts leading to the above issue are that during the course of assessment proceedings AO noticed that assessee has earned dividend income of Rs.1,65,924/- and claimed the same as exempt u/s. 10(34) of the Act. The AO required the assessee to furnish the details of expenditure incurred for earning this dividend income. The assessee in reply stated that no expenditure has been incurred to earn this dividend income because no new investment was made during the year and no interest at all is paid on the investments made for earning this dividend income. Further, it was clarified by the assessee that no loans were taken for making this investment for earning this dividend income. The AO was not convinced with the reply of the assessee and made disallowance simply by making calculation by applying Rule 8D of the I. T. Rules, 1962 as under:

“i) Direct expenses : In the P&L A/c no item of expenditure is identified which can be directly attributable to earning of such income or making of the long term investments listed above. Therefore, this figure is adopted at NIL.

*ii) Disallowance of Interest not invoked. Amount to be disallowed $A*B/C = \text{NIL}$*

*iii) Disallowance of $\frac{1}{2}\%$ of average value of investment $\text{Rs.}107,29,27,282/- * 0.5\% = \text{Rs.}53,64,636/-$*

Total disallowance u/s. 14A Rs.53,64,636/- “

7. Aggrieved, assessee challenged the disallowance made by invoking the provisions of section 14A read with Rule 8D of the I. T. Rules at Rs.3243231/- before CIT(A). CIT(A) after considering the submissions of the assessee deleted the disallowance. Aggrieved, revenue is in appeal before us.

8. Before us, Ld. Sr. DR only relied on the assessment order. We find that the AO has not brought on record anything which proves that there is any expenditure incurred towards earning of this dividend income. The assessee before us clarified that it has own funds to cover up the entire investment of Rs.110,79,27,282/-. The assessee before us stated that it has accumulated funds i.e. share capital and reserves surplus at Rs.602,22,55,755/-. The assessee before us also contended that no loans or borrowed funds were taken for making investment in shares. This issue is covered by the decision of Mumbai Tribunal in the case of J. K. Investors (Bombay) Ltd. Vs. ACIT in ITA No.7858/Mum/2011, AY 2008-09 dated 13.03.2013, wherein it has been held as under:

11. We have heard the arguments of the parties and have perused the material placed before us. The issue as carved out by the AR is with respect to Rs.10,000 only, but on the contrary, the issue before us is on the applicability of Rule 14A and computation of disallowance as per Rule 8D. The relevant portion read out by the AR from the decision in the case of Godrej & Boyce Mfg. Co. Ltd vs. DCIT (supra) in Para 70 of the order pertains to the correctness of computation of disallowance and giving valid reasons for such computation. The crux of argument of AR is with reference to Section 14(2) which is as under:

“The Assessing Officer shall determine the amount of expenditure incurred in relation to such income which does not form part of the total income under this Act in accordance with such method as may be prescribed, if AO having regard to the accounts of assessee, is not satisfied with the correctness of the claim of assessee in respect of such expenditure in relation to income which does not form part of the total income under this Act”.

The words that need reference in the section are “if AO having regard to the accounts of assessee, is not satisfied with the correctness of the claim...” means that before going to the computation, AO has to cross the barrier of the satisfaction with the correctness of the claim, then AO can be permitted to straightaway apply the computation under Rule 8D.

12. Thus the issue in this appeal is with reference to invoking of provisions of section 14A(2) and Rule 8D. The Hon'ble Bombay High Court while upholding the constitutional validity of the section 14A and Rule 8D has this to observe with reference to sub section 2 & 3 of section 14A:

“Sub-sections (2) and (3) of section 14A were inserted by an amendment brought about by the Finance Act of 2006 with effect from April 1, 2007. Under sub-section (2), the Assessing Officer is required to determine the amount of expenditure incurred by an assessee in relation to such income which does not form part of the total income under the Act in accordance with such method as may be prescribed. Sub-section (2) was inserted so as to provide a uniform method applicable where the Assessing Officer is not satisfied with the correctness of the claim of the assessee. Parliament has provided an adequate safeguard to the invocation of the power to determine the expenditure incurred in relation to the earning of nontaxable income by adoption of the prescribed method. The invocation of the power is made conditional on the objective satisfaction of the Assessing Officer in regard to the correctness of the claim of the assessee, having regard to the accounts of the assessee. These safeguards which are implicit in the requirements of fairness and fair procedure under article 14 must be observed by the Assessing Officer when he arrives at his satisfaction under sub-section (2) of section 14A. Sub-rule (1) of rule 8D of the Income-tax Rules, 1962, has also incorporated the essential requirements of subsection (2) of section 14A before the Assessing Officer proceeds to apply the method prescribed under sub-rule (2)” .. (emphasis supplied).

13. The same opinion was expressed by the Hon'ble Delhi High Court in the case of *Maxopp Investment Ltd and Others v. CIT* 247 CTR 162 wherein reliance was placed on the decision of the Hon'ble Supreme Court in the case of *CIT vs. Walfort Share & Stock Brokers Pvt. Ltd* 326 ITR 1 (SC) and the decision of the Hon'ble Bombay High Court in the case of *Godrej and Boyce Company Ltd vs. DCIT* (328 ITR 81). The relevant portions of the judgment of Hon'ble Delhi High Court are as under:

29. Sub-section (2) of Section 14 A of the said Act provides the manner in which the Assessing Officer is to determine the amount of expenditure incurred in relation to income which does not form part of the total income. However, if we examine the provision carefully, we would find that the Assessing Officer is required to determine the amount of such expenditure only if the Assessing Officer, having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee in respect of such

expenditure in relation to income which does not form part of the total income under the said Act. In other words, the requirement of the Assessing Officer embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if the Assessing Officer returns a finding that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Therefore, the condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Sub-section (3) is nothing but an offshoot of sub-section (2) of Section 14A. Subsection (3) applies to cases where the assessee claims that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act. In other words, sub-section (2) deals with cases where the assessee specifies a positive amount of expenditure in relation to income which does not form part of the total income under the said Act and sub-section (3) applies to cases where the assessee asserts that no expenditure had been incurred in relation to exempt income. In both cases, the Assessing Officer, if satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure, as the case may be, cannot embark upon a determination of the amount of expenditure in accordance with any prescribed method, as mentioned in sub-section (2) of Section 14A of the said Act. It is only if the Assessing Officer is not satisfied with the correctness of the claim of the assessee, in both cases, that the Assessing Officer gets jurisdiction to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the said Act in accordance with the prescribed method. The prescribed method being the method stipulated in Rule 8D of the said Rules. While rejecting the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the Assessing Officer would have to indicate cogent reasons for the same.

Rule 8D.

30. As we have already noticed, sub-section (2) of Section 14A of the said Act refers to the method of determination of the amount of expenditure incurred in relation to exempt income. The expression used is – "such method as may be prescribed". We have already mentioned above that by virtue of Notification No.45/2008 dated 24/03/2008, the Central Board of Direct Taxes introduced Rule 8D in the said Rules. The said Rule 8D also makes it clear that where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with (a) the correctness of the claim of expenditure made

by the assessee; or (b) the claim made by the assessee that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act for such previous year, the Assessing Officer shall determine the amount of the expenditure in relation to such income in accordance with the provisions of sub-rule (2) of Rule 8D. We may observe that Rule 8D(1) places the provisions of Section 14A(2) and (3) in the correct perspective. As we have already seen, while discussing the provisions of Sub-sections (2) and (3) of Section 14A, the condition precedent for the Assessing Officer to himself determine the amount of expenditure is that he must record his dissatisfaction with the correctness of the claim of expenditure made by the assessee or with the correctness of the claim made by the assessee that no expenditure has been incurred. It is only when this condition precedent is satisfied that the Assessing Officer is required to determine the amount of expenditure in relation to income not includable in total income in the manner indicated in sub-rule (2) of Rule 8D of the said Rules.

31. It is, therefore, clear that determination of the amount of expenditure in relation to exempt income under Rule 8D would only come into play when the Assessing Officer rejects the claim of the assessee in this regard. If one examines sub-rule (2) of Rule 8D, we find that the method for determining the expenditure in relation to exempt income has three components. The first component being the amount of expenditure directly relating to income which does not form part of the total income. The second component being computed on the basis of the formula given therein in a case where the assessee incurs expenditure by way of interest which is not directly attributable to any particular income or receipt. The formula essentially apportions the amount of expenditure by way of interest [other than the amount of interest included in clause (i)] incurred during the previous year in the ratio of the average value of investment, income from which does not or shall not form part of the total income, to the average of the total assets of the assessee. The third component is an artificial figure - one half percent of the average value of the investment, income from which does not or shall not form part of the total income, as appearing in the balance sheets of assessee, on the first day and the last day of the previous year, It is the aggregate of these three components which would constitute the expenditure in relation to exempt income and it is this amount of expenditure which would be disallowed under section 14A of the said Act. It is, therefore, clear that in terms of the said Rule, the amount of expenditure in relation to exempt income has two aspects – (a) direct and (b) indirect. The direct expenditure is straightaway taken into account by virtue of clause (i) of sub-rule (2) of Rule 8D. The indirect expenditure, where it is by way of interest, is computed through the principle of apportionment, as indicated above, and, in cases where the indirect expenditure is not by way of interest, a

rule of thumb figure of one half percent of the average value of the investment, income from which does not or shall not form part of the total income, is taken.

41. Sub-section (2) of section 14A, as we have seen, stipulates that the Assessing Officer shall determine the amount of expenditure incurred in relation to income which does not form part of the total income "in accordance with such method as may be prescribed". of course, this determination can only be undertaken if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. This part of section 14A(2) which explicitly requires the fulfillment of a condition precedent is also implicit in section 14A(1) [as it now stands] as also in its initial avatar as section 14A. It is only the prescription with regard to the method of determining such expenditure which is new and which will operate prospectively. In other words, section 14A, even prior to the introduction of sub-sections (2) and (3) would require the assessing officer to first reject the claim of the assessee with regard to the extent of such expenditure and such rejection must be for disclosed cogent reasons. It is then that the question of determination of such expenditure by the assessing officer would arise. The requirement of adopting a specific method of determining such expenditure has been introduced by virtue of sub-section (2) of section 14A. Prior to that, the assessing was free to adopt any reasonable and acceptable method.

14. The Hon'ble Punjab & Haryana High Court in the case of CIT vs. Hero Cycles Ltd 323 ITR 518 (P&H) has also held that disallowance under section 14A could not stand where it was found that for earning exempted income no expenditure has been incurred:

“Held - dismissing the appeal, that the expenditure on interest was set off against the income from interest and the investment in the shares and funds were out of the dividend proceeds. In view of this finding of fact, disallowance under section 14A was not sustainable. Whether, in a given situation, any expenditure was incurred which was to be disallowed, was a question of fact. The contention of the Revenue that directly or indirectly some expenditure was always incurred which must be disallowed under section 14A and the impact of expenditure so incurred could not be allowed to be set off against the business income which may nullify the mandate of section 14A, could not be accepted. Disallowance under section 14A required finding of incurring of expenditure and where it was found that for earning exempted income no expenditure had been incurred, disallowance under section 14A could not stand. Consequently, the disallowance was not permissible.

15. *The Coordinate Bench in the case of Justice Sam P Bharucha vs. Addl. CIT in ITA No.3889/Mum/2011 dated 25.07.2012 has analyzed similar issue and came to the following conclusion:*

“5 We have considered the rival submissions as well as relevant material on record. Section 14A has within it implicit notion of apportionment in the cases where the expenditure is incurred for the composite/indivisible activities in which taxable and non-taxable income is received. But when it is possible to determine the actual expenditure in relation to the exempt income or when no expenditure has been incurred in relation to the exempt income, then principle of apportionment embedded in section 14 A has no application. The objective of section 14 A is not allowing to reduce tax payable on the normal exempt income by debiting the expenditure incurred to earn the exempt income. Thus, the expenses incurred to earn exempt income cannot be allowed and the expenses shall be allowed only to the extent they are related to the earning of taxable income. If there is expenditure directly or indirectly incurred in relation to exempt income, the same cannot be claimed against the income, which is taxable as it is held by the Hon'ble Supreme Court in case of Commissioner of Income-tax v. Walfort Share and Stock Brokers P. Ltd. reported in 326 ITR 1 that for attracting the provisions of section 14 A, there should be proximate cause for disallowance which as relationship with the tax exempt income.

5.1 The expenditure incurred in relation to the income which does not form part of total income has to be disallowed. However, it should be proximate relationship between the expenditure and the income, which does not form part of total income. Once such proximity relationships exist, the disallowance is to be effected. In case the assessee had claimed that no expenditure has been incurred for earning the exempt income, it was for the assessing officer to determine as to whether the assessee had incurred any expenditure in relation to income which did not form part of total income and if so to quantify the extent of disallowance. Thus, in order to disallow the expenditure under section 14A, there must be a live nexus between the expenditure incurred and the income not forming part of total income. No notional expenditure can be apportioned for the purpose of earning exempt income unless there is an actual expenditure in relation to earning the income not forming part of total income. If the expenditure is incurred with a view to earn taxable income and there is apparent dominant and immediate

connection between the expenditure incurred and taxable income, then no disallowance can be made under section 14A merely because some tax exempt income is received by the assessee.

5.2 Averting to the facts of the case in hand, the assessee had made a claim that no expenditure has been incurred or claimed for earning the exempt income. From the details of the expenditure, it is clear that the expenditure incurred and claimed by the assessee has direct nexus with the professional income of the assessee. It is not the case of the revenue that the assessee has used his official machinery and Establishment for earning the exempt income. The Assessing Officer has not given any finding that any of the expenditure incurred and claimed by the assessee is attributable for earning the exempt income. In other words when the assessing officer has not pointed out that certain expenditure is not incurred for earning the professional income; but are incurred in relation to dividend income or such expenditure is incurred for inseparable and indivisible activities comprising professional as well as the activities on which is exempt income has been earned by the assessee, then in the absence of any such instance of expenditure, finding of Assessing Officer or any material to show that the expenditure incurred and claimed by the assessee against the taxable income has any relation for earning the exempt income, the provisions of section 14A cannot be applied.

5.3 In the case of Shri Pawan Kumar Parameshwar Lal vs. ACIT (supra) this tribunal has considered and decided an identical issue in Para 4 as under:

“4. After hearing the assessee in person and arguments of the learned D.R. we are of the opinion that no disallowance is called for under section 14A. Obviously the assessee is maintaining separate books of account for purpose of business and these investments are in his personal capacity. The A.O. also has not disallowed any expenditure of personal nature out of the income from business or profession in the computation of income in the assessment order. In view of this, we are of the opinion that the expenditure claimed in the business of share dealings cannot be correlated to the incomes earned in personal capacity that too on dividend, PPF interest and tax free interest on RBI bonds. In view of this, we are of the opinion that estimation of expenditure of `20,000/- out of business expenditure claimed in business activity cannot be considered for being incurred for this earning of tax free income of above nature. In view of this disallowance so made under section 14A of `20,000/- is deleted. Not only that the

CIT(A) directed the A.O. to consider the allowance invoking Rule 8D. The Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. vs. DCIT 328 ITR 81 has considered Rule 8D to be applicable prospective and since the assessment year involved is before the introduction of sub section (2) & (3) of section 14A, there is no question of disallowing the amounts invoking Rule 8D. Therefore, the CIT(A)'s direction on this is set aside and the additions so made by the A.O. in the computation of business income is deleted. Ground is considered allowed.” 5.4 Similarly in case of Auchtel Products Ltd (supra), it was held by this Tribunal in Para 15 as under: “15. A bare perusal of the above provisions disallowable as per Rule 8D, if he, “is not satisfied with the correctness of the claim of the assessee” in respect of such expenditure in relation to exempt income. Even if the assessee claims that no expenditure was incurred in respect of exempt income, the AO is supposed to follow the mandate of Rule 8D if he is not satisfied with the correctness of the assessee's claim. To put it simply, the further disallowance u/s. 14A is called for when the AO is not satisfied with the assessee's claim of having incurred no expenditure or some amount of expenditure in relation to exempt income. Satisfaction of the AO as to the incorrect claim made by the assessee in this regard is sine qua non for invoking the applicability of Rule 8D. Such satisfaction can be reached and recorded only when the claim of the assessee is verified. If the assessee proves before the AO that it incurred a particular expenditure in respect of earning the exempt income and the AO gets satisfied, then there is no requirement to still proceed with the computation of amount disallowable as per Rule 8D. From the assessment order, it is observed that the AO simply kept the assessee's submissions on record without appreciating as to whether these were correct or not. He proceeded on the premise as if the disallowance as per Rule 8D is automatic irrespective of the genuineness of the assessee's claim in respect of expenses incurred in relation to exempt income. It is an incorrect course adopted by the AO. The correct sequence, in our considered opinion, for making any disallowance u/s. 14A is to, firstly, examine the assessee's claim of having incurred some expenditure or no expenditure in relation to exempt income, If the AO gets satisfied with the same, then there is no need to compute disallowance as per Rule 8D. It is only when the AO is not satisfied with the correctness of the claim of assessee in respect of such expenditure or no expenditure having been incurred in relation to exempt income, that the mandate of Rule 8D will operate. In the instant case, the authorities below have directly gone to the second stage of computing disallowance u/s. 14A as per Rule 8D without rendering any

opinion on the correctness or otherwise of the assessee's claim in this regard. We, therefore, set aside the impugned order on this issue and restore the matter to the file of AO to re-compute disallowance, if any, in accordance with our above observations after duly examining the assessee's claim in this regard.

” 6. In view of the above discussion and facts and circumstances of the case, we are of the considered opinion that no disallowance under section 14A is called for when the assessee has not incurred and claimed any expenditure for earning the exempt income.

16. Similar views were also expressed by the Coordinate Benches in the case of Relaxo Footwears Ltd, vs. Addl. CIT (2012) 50 SOT 102 and Priya Exhibitors (P) Ltd vs. ACIT (2012) 54 SOT 356. In the case of Relaxo Footwears Ltd, it was held as under:

“The Assessing Officer should have considered the claim of the assessee that no expenditure has been incurred in relation to earning the exempt income. If the claim was not found to be in consonance with the facts on record, it could have been rejected and disallowance could have been made as per rule 8D. However, it is found that the Assessing Officer has not considered the claim of the assessee at all and he has straightway embarked upon computing disallowance under rule 8D. The Commissioner (Appeals) made an assumption that whenever exempt income is earned there will be some expenditure incurred in relation thereto. Such presumption cannot form the basis for making disallowance under rule 8D.”

17. In the case of Priya Exhibitors (P) Ltd vs. ACIT (2012) 54 SOT 356 it was held as under:

“From the careful study of the observations made by the Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. (supra), it is apparent that first the Assessing Officer has to determine the claim of the assessee regarding expenses which neither the Assessing Officer nor the Commissioner (Appeals) has done in the instant case. In fact, the said decision goes against the department itself in so far as their Lordships has held that the Assessing Officer must in the first instance determine whether the claim of the assessee is correct and determination must be made having regard to the accounts of the assessee. The Legislature directs him to follow rule 8D only where the Assessing Officer is not satisfied with the claim of assessee. ”

18. After considering the principles laid down by various judgments, it is imperative that the Assessing Officer can invoke Rule 8D only when he records satisfaction in regard to the correctness of the claim of the assessee,

having regard to the accounts of the assessee. The condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. While rejecting the claim of the assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the Assessing Officer would have to indicate cogent reasons for the same. Therefore, it is all the more necessary that AO has to examine the accounts of assessee first and then if he is not satisfied with the correctness of the claim, only he can invoke Rule 8D. No such examination was made or satisfaction was recorded by AO in this case. It was noticed that the Assessing Officer has not considered the claim of the assessee at all and he has straightway embarked upon computing disallowance under Rule 8D on the presumption that port folio management involves at least 2% of charges. Disallowance under section 14A required finding of incurring of expenditure and where it was found that for earning exempted income no expenditure had been incurred, disallowance under section 14A could not stand. We notice that assessee itself disallowed the interest which is directly applicable, Dmat charges and administrative exp on estimation totaling to Rs.1,55,44,610. Assessee is a hundred crore turnover company. AO has not examined any expenditure claimed in P& L account so as to relate to exempt income, nor gave a finding that assessee claim is not correct for any reason. Rule 8D cannot be invoked directly without satisfying about the claims or otherwise. Consequently, the disallowance was not permissible. We therefore, allow the ground of appeal.”

9. We find from the facts of the above case that the AO has not examined the accounts of the assessee and there is no satisfaction recorded by the AO about the correctness of the claim of the assessee and without the same he invoked Rule 8D of the Rules. While rejecting the claim of the assessee with regard to expenditure or no expenditure, as the case may be, in relation to exempted income, the AO has to indicate cogent reasons for the same. From the facts of the present case it is noticed that the AO has not considered the claim of the assessee and straight away embarked upon computing disallowance under Rule 8D of the Rules on presuming the average value of investment at 1/2% of the total value. In view of the above and respectfully following the coordinate bench decision in the case of J. K. Investors (Bombay) Ltd., supra, we uphold the order of CIT(A). This ground of appeal of revenue is dismissed.

50. The facts of aforementioned case are that during the course of assessment proceedings AO noticed that assessee has earned dividend income of Rs.1,65,924/- and claimed the same as exempt u/s. 10(34) of the Act. The AO required the assessee to furnish the details of expenditure incurred for earning this dividend income. The assessee in reply stated that no expenditure has been incurred to earn the said dividend income. The AO was not convinced with the reply of the assessee and made disallowance by making calculation by applying Rule 8D of the Rules. The Tribunal *supra* held that the AO has not examined the accounts of the assessee and there is no satisfaction recorded by the AO about the correctness of the claim of the assessee and without the same he invoked Rule 8D of the Rules. While holding the action of AO invoking the Rule 8D is bad under law, the Tribunal taken support from the ratio of the Hon'ble Delhi High Court in the case of Maxopp Investment Ltd and Others v. CIT 247 CTR 162. The facts in the aforementioned case are clearly applicable to the facts of the case, In view of the same, we hold that the AO did not verify the accounts and claim of the assessee while applying Rule 8D and computing expenditure thereon, and, therefore, the order of the CIT-A is quashed and the grounds raised by the assessee are allowed.

51. In the result, the appeals of Revenue in ITA 2123/Kol/13 and ITA 2124/Kol/13 are dismissed and Cross Objection in CO 30/Kol/ 2014 of the assessee is allowed.

Order Pronounced in the Open Court on 12th August, 2016.

Sd/-
P.M.Jagtap
ACCOUNTANT MEMBER

Sd/-
S.S.Viswanethra Ravi
JUDICIAL MEMBER

Dated: 12 /08 /2016

PP/Sr.PS

Copy of order forwarded to:

- 1 Deputy Commissioner of Income Tax, Cir-10, P-7 Chowringhee Square, 3rd Floor, Kolkata-69.
- 2 M/s. Philips Carbon Black Ltd 'Duncan House '31 Netaji Subhas Road, Kolkata-700 001.
- 3 The CIT(A),
- 4 CIT,
- 5 D.R.

True Copy,

By order,

Asstt. Registrar, ITAT, Kolkata