

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES: "E" NEW DELHI**

**BEFORE SHRI J.SUDHAKAR REDDY, ACCOUNTANT MEMBER
AND SHRI RAJPAL YADAV, JUDICIAL MEMBER**

**ITA No: 4294/Del/2012
Assessment Year : - 2009-10**

Modern Info Technology P.Ltd. vs. ITO, Ward 5(4)
305, 3rd floor, Bhanot corner New Delhi
Pamposh Enclave, GK I
New Delhi

(Appellant)

(Respondent)

Appellant by : Shri Suresh Anantharaman, C.A.
Respondent by : Shri SK Jain, Sr.D.R.

ORDER

PER J.SUDHAKAR REDDY, ACCOUNTANT MEMBER

This is an appeal filed by the assessee directed against the order of the Commissioner of Income Tax (Appeals) dated 17.7.2012 for the Assessment Year 2009-10.

2. Facts in brief:- The assessee is a Private Limited Company. It filed its return of income on 26.9.2009 declaring a loss of Rs.26,498/-. The assessee company had dividend income of Rs.41,82,220/-, which claimed as exempt under Section 10(34) of the Income Tax Act, 1961. The only other income assessee had was bank interest of Rs.19,941/-. The assessee capitalized the interest expenditure and had not claimed the same as an expense either in the Profit & Loss a/c or in its income tax computation. The Assessing Officer made a disallowance under

Section 14A read with Rule 8D on an amount of Rs.45 lakhs being interest paid to ICICI bank on purchase of shares of Uflex Ltd. and a further amount of Rs.6,51,918/- being ½% of average investment under Rule 8D(2).

3. On appeal the First Appellate Authority upheld the order of the Assessing Officer. Further aggrieved, the assessee is in appeal before us.

4. The Ld.Counsel for the assessee Mr.Suresh Anantharaman submitted that Rs.45 lakhs is added to the income of the assessee, under Section 14A, though the assessee has not claimed the same as an expense. He argued that an amount cannot be disallowed when the same is not claimed. On the second issue he pointed out that the assessee had incurred and claimed expenditure of Rs.45,977/- being audit fees, general expenses and conveyance and hence the disallowance of a higher amount by applying the Rule 8D(2) is bad in law. He argued that only actual expenses can be disallowed. He relied on the following cases:-

i. CIT vs. Gillette Group India P.Ltd. vs ACIT (ITA no.267Del/2012) Delhi 'C' Bench order dt. 23.3.2012.

ii. M/s Search Enviro Ltd. vs. ACIT vs. Jindal Photo Ltd. in ITA 3464/Mum/2011, Mumbai 'E' Bench order dt. 2.3.2012

5. The Ld.D.R. on the other hand relied on the order of the Commissioner of Income Tax (Appeals) and submitted that the assessee has wrongly capitalized the interest of Rs.45 lakhs. He argued that the

assessee should have claimed the interest on an 'year to year' basis, as was held by the Tribunal in a number of cases. On the disallowance by application of Rule 8D, he submitted that the same is mandatory.

6. Rival contentions heard. On a careful consideration of the facts and circumstances of the case, a perusal of the material available on record and case laws cited, we hold as follows.

7. No amount can be disallowed, when it is not claimed as an expense. The assessee has not claimed Rs.45 lakhs as an expense while computing its income. Under the circumstances, making a disallowance under Section 14A is bad in law. We do not understand how an expenditure can be disallowed, when the same has not been claimed as a deduction.

8. If the Department's argument that the assessee should have claimed the expense is accepted, then the Revenue should show this amount of expenditure as a deduction, in the computation of income and then, only disallow the same under Section 14(A) of the Act. This would result in 'nil' addition.

9. If the Revenue is of the opinion that the assessee has wrongly capitalized the interest expenditure, it should be looked into and examined when the assessee declares capital gains/loss on the transaction. Looking at the issue from any angle, we have to allow this ground of the assessee and delete the disallowance of interest expenditure.

10. Coming to the second issue, we find that the assessee has claimed that it had incurred total expenditure of Rs.45,977/- during the year. While so the Assessing Officer has disclosed Rs.6,51,918/-. Thus the disallowance is for in excess of the actual expenditure in this case.

11. The Mumbai 'J' Bench of the Tribunal in the case of Justice Sam P Bharucha vs ACIT, order dt. 25th July, 2012 had held as follows.

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 14A has no application. The objective of section 14A 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 Honourable 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 silicone, permissible Lal versus 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 DR 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 AO 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 Rs. 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 Assessing Officer to consider the allowance invoking Rule 80. The Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co, Ltd, vs. DCIT 328 ITR 81 has considered Rule 80 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 AO, 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 indicates that the AO shall determine the amount 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 80. 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 D 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 80. It is only when the AO is not satisfied with the correctness of the claim of the 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 recompute 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.

12. By applying the propositions laid down, to the facts of the case we hold that the disallowance cannot exceed the total actual expenditure incurred and claimed by the assessee. In this case the total expenditure claimed by the assessee in the Profit and Loss account is Rs.45,977/-. Thus the disallowance should be restricted to this amount. Thus we allow this ground in part.

12. In the result, the appeal by the assessee is allowed in part.

Order pronounced in the Open Court on 19th October, 2012.

Sd/-

(RAJPAL YADAV)
JUDICIAL MEMBER

Sd/-

(J.SUDHAKAR REDDY)
ACCOUNTANT MEMBER

Dated: the 19th October, 2012

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Copy of the Order forwarded to:

1. Appellant; 2.Respondent; 3.CIT; 4.CIT(A); 5.DR; 6.Guard File

By Order

Dy. Registrar