

IN THE INCOME TAX APPELLATE TRIBUNAL  
' C ' BENCH, CHENNAI

BEFORE Dr. O.K. NARAYANAN, VICE-PRESIDENT  
AND SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER

ITA No. 305/Mds/2013  
(Assessment Year: 2009-10)

Deputy Commissioner of Income  
Tax,  
Company Circle-I(1),  
121, M.G.Road,  
Chennai-34.

(Appellant)

Vs. M/s. Allied Investments Housing  
P.Ltd.,  
13, Venkataraman Street,  
T.Nagar,  
Chennai-600 017.  
PAN: AAACA7460P  
(Respondent)

Appellant by : Mr. T.N.Betgeri, JCIT  
Respondent by : Mr. Saroj Kumar Parida, Advocate

Date of Hearing : 7<sup>th</sup> November, 2013  
Date of Pronouncement : 7<sup>th</sup> November, 2013

**ORDER**

Per Challa Nagendra Prasad, JM :

This appeal is filed by the Revenue against the order of the Commissioner of Income Tax (Appeals)-III, Chennai dated 20.11.2012 for the assessment year 2009-10. The only grievance of the Revenue in this appeal is that the Commissioner of Income Tax (Appeals) erred in restricting the disallowance under section 14A of the Act to ₹ 50,000/- as against disallowance of ₹ 58,64,016/- made by the Assessing Officer.

2. The Assessing Officer while completing the assessments disallowed ₹ 58,64,016/- invoking the provisions of section 14A read with Rule 8D. The assessee filed an appeal before the Commissioner of Income Tax (Appeals) contending that the Assessing Officer has not recorded any satisfaction as to the correctness of the assessee's claim that it had not incurred expenditure more than 2% of the dividend income earned. The appellant contended that it had not made any fresh investment during the year and the dividend was received from unlisted company out of the investment in shares of the company made in the year 2003-04. The interest expenditure incurred by the assessee during the assessment year does not relate to earning of exempt income. The Assessing Officer has not pointed out any direct nexus between the interest expenditure incurred and the exempt income earned during the year. Therefore, there is no justification in disallowing ₹ 58,64,016/- under section 14A read with Rule 8D. The Commissioner of Income Tax (Appeals) considering the submissions of the assessee

restricted the disallowance to ₹ 50,000/- under section 14A of the Act against which the Revenue is in appeal before us.

3. The Departmental Representative supports the order of the Assessing Officer .

4. The counsel for the assessee supports the order of the Commissioner of Income Tax (Appeals) and also places reliance on the decision of the co-ordinate Bench of this Tribunal in the case of Shiva Distilleries in ITA No.2125/Mds/2012 dated 26.8.2013 in support of his contention that in the absence of any satisfaction recorded by the Assessing Officer in regard to the correctness of the claim of the assessee that it had not incurred any expenditure, no disallowance under section 14A of the Act can be made.

5. Heard both sides. Perused the orders of the lower authorities and the order of this Tribunal relied on by the counsel for the assessee. The Commissioner of Income Tax (Appeals) after considering the submissions of the

assessee elaborately discussed the circumstances under which the provisions of section 14A read with Rule 8D especially the interest income cannot be subjected to disallowance observing as under:-

*“4.2 I have carefully considered the facts of the case and the submissions of the Id. AR. I have also gone through the decisions relied on by the AO and the AR. The AO has applied rule 8D for the above disallowance because funds for the appellant came in a common kitty and the appellant could not clearly show the utilization of the funds. The appellant has strongly contested the disallowance made by the AO. From the details of investments filed, it is found that the value of total investments as on 31.3.2008 was ₹ 12,81,09,1102/- and as on 31.3.2009 it was ₹ 4,93,16,401/-, the decrease in the value of investments was due to loss in partnership firm. The details of exempt income filed by the appellant reveal that dividend income was received from the investments made in M/sVaigai Chemical Industries Ltd., this investment was made in the year 2003-04, there was no fresh investment in the relevant assessment year in this company from which dividend was received. Appellant has given break-up of interest expenditure of ₹ 1,13,15,453/-, from the details reproduced in para 4.1.3 (supra), it is noted that no part of interest expenditure can be*

*attributed to any borrowing which was utilised for making investments which could generate exempt income. From the above discussion, the following points emerge:*

*1. The appellant did not make any fresh investment during the year which could generate exempt income in forthcoming years.*

*2. The exempt income of Rs.3,33,320/- earned by the appellant during the year comprised of dividend received from an unlisted company M/s. Vaigai Chemical Industries Ltd, investment in the shares of this company was made in the year 2003-04.*

*3. The appellant incurred interest expenditure of ₹ 1,13,15,453/- during the year under five major heads, none of which is directly related to earning of exempt income.*

*4. The AO has not pointed out any direct nexus between the interest expenditure incurred and the exempt income earned during the year.*

*4.3. It is pertinent to mention here the decision of the Mumbai Tribunal in the case of M/s. Krishna Land Developers Pvt. Ltd A.Y. 2008-09*

wherein the Assessing Officer made a disallowance of Rs. 31 lakhs under section 14A of the Act by applying Rule 8D without recording any satisfaction as to how the assessee's calculation of section 14A disallowance was incorrect. The ITAT held that it is a prerequisite that before invoking Rule 8D, the must record his satisfaction on how the assessee's calculation is incorrect. The AO cannot apply Rule 8D without pointing out any inaccuracy in the method of apportionment or allocation of expenses. Further, the onus is on the AO to show that expenditure has been incurred by the assessee for earning tax-free income. Without discharging the onus, the AO is not entitled to make an ad hoc disallowance. A clear finding of incurring of expenditure is necessary. No disallowance can be made on the basis of presumptions.

Further, the Punjab & Haryana High Court in the case of **CIT vs Hero Cycles Ltd (2010) (323 ITR 518)** has held that for the purpose of disallowance under section 14A of the Act, expenses must have been incurred for the purpose of earning exempt income. The mere fact that some interest expenses were incurred cannot be the reason for disallowance unless the nexus between the expense and the exempt income is established.

"It is held in the case of *Godrej and Boyce Mfg Co. Ltd vs. DC IT (194 Taxman 203)* High Court of Bombay) "Sub-section (2) of section 14A does not enable the AO to apply the method prescribed by rule 8D without

*determining in the first instance the correctness of the claim of the assessee, having regard to the accounts of the assessee. Sub-section (2) of section 14A mandates that it is only when, having regard to the accounts of the assessee, the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure incurred in relation to income which does not form part of the total income under the Act, that he can proceed to make a determination under the Rules. The satisfaction envisaged by sub-section (2) of section 14A is an objective satisfaction that has to be arrived at by the Assessing Officer having regard to the accounts of the assessee. The safeguard introduced by sub-section (2) of section 14A for a fair and reasonable exercise of power by the Assessing Officer, conditioned as it is by the requirement of an objective satisfaction, must, therefore, be scrupulously observed. An objective satisfaction contemplates a notice to the assessee, an opportunity to the assessee to place on record all the relevant facts including his accounts and recording of reasons by the Assessing Officer in the event he comes to the conclusion that he is not satisfied with the claim of the assessee. "*

*From the above discussion, it transpires that the objective satisfaction of the AO as to the correctness of the assessee's claim was*

*not recorded in the instant case. However, even if Rule 8D cannot be applied, the AO is obliged to ascertain the expenditure which had been incurred to earn the tax-free income. He must adopt a reasonable basis consistent with the relevant facts and circumstances of the case. The appellant's dividend income during the year is Rs. 3,33,320/- and appellant estimated an expenditure of 2% of dividend income as related to exempt income and disallowed an amount of Rs.6,666/- in the computation of total income. The expenditure estimated by the appellant appears to be highly inadequate. Appellant has to incur various direct and indirect expenses in as much as the efforts*

*of the employees go in tracking the mutual fund and other investments, purchase and sale of mutual funds and other assets, deposit of the dividend warrants, portfolio management etc. Considering the facts and circumstances of the case and judicial precedents discussed in preceding paras, a sum of Rs. 50,000/- is considered as reasonable expenditure to earn the exempt income. Accordingly, the disallowance is restricted to Rs.50,000/-. This ground is **partly allowed.** ”*

6. On a careful reading of the order of the Commissioner of Income Tax (Appeals), we do not find any valid reason to



interfere with the findings of the Commissioner of Income Tax (Appeals). The grounds raised by the Revenue are rejected.

7. In the result, the appeal of the Revenue is dismissed.

Order pronounced in the open court at the time of hearing on Thursday, the 7<sup>th</sup> day of November, 2013 at Chennai.

Sd/-  
(Dr. O.K.Narayanan )  
Vice-President

Sd/-  
(Challa Nagendra Prasad)  
Judicial Member

Chennai,  
Dated the 7<sup>th</sup> November, 2013.

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Copy to:           (1) Appellant           (4) CIT(A)  
                          (2) Respondent       (5) D.R.  
                          (3) CIT                   (6) G.F.