

IN THE INCOME TAX APPELLATE TRIBUNAL, MUMBAI BENCH 'F' MUMBAI

BEFORE SHRI SHAILENDRA KUMAR YADAV, JUDICIAL MEMBER AND
SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER

ITA NO 5366/Mum/2012

Assessment year: - 2009-10.

ACIT, Circle -3(3), Room No. 609, 6 th floor, Aaykar Bhavan, M.K. Road, Mumbai – 400 020.	Vs.`	M/s Uma Polymers Ltd. 807, Tulsiani Chambers, 212, Nariman Point, Mumbai – 400 021.
PAN/GIR No. AAACU0748E		
Appellant		Respondent

CO No. 234/Mum/2013

Arising out of ITA NO 5366/Mum/2013

Assessment year: - 2009-10.

M/s Uma Polymers Ltd. 807, Tulsiani Chambers, 212, Nariman Point, Mumbai – 400 021.	Vs.`	ACIT, Circle -3(3), Room No. 609, 6 th floor, Aaykar Bhavan, M.K. Road, Mumbai – 400 020.
PAN/GIR No. AAACU0748E		
Appellant		Respondent

Revenue By	Shri Abani Kanta Nayak
Assessee By	Shri Rajendra Jain
Date of hearing	10.09.2015
Date of pronouncement	30.09.2015

ORDER

Per Ramit Kochar, Accountant Member

This appeal by the Revenue and Cross objection by the assessee are directed against the order passed by Commissioner of Income Tax(Appeals)-7,Mumbai (Hereinafter called "the CIT(A)") dated 20/04/2012 for assessment year 2009-10.

2. The Revenue has taken following grounds of appeal in the memo of appeal filed :-

“1. Whether on the facts and circumstances of the case and in law, the Ld. C(T)A was justified in deleting the disallowance u/s. 14A to the extent of Rs. 35,21,564/- under Rule 8D(2)(ii) without appreciating the fact that the assessee has failed to prove that it has not invested its borrowed funds in respect of shares which are held as investment pertaining to exempt income.

2. The appellant prays that the order of CIT(A) on the above ground be set aside and that of the Assessing officer be restored.”

The assessee company has raised following grounds in the cross objection filed:

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- 1. The Ld. CIT(A)-7, Mumbai on the facts and in circumstances rightly held that the AO was not justified in making disallowance u/s 14A for AY 2009-10 to the extent of Rs.35,21,564.*
- 2. That the Ld. CIT(A)-7, Mumbai in the facts and circumstances of the case erred in sustaining disallowances u/s 14A to the extent of Rs.7,21,989 holding that the respondent company had incurred administrative and other expenses in earning exempt income and as per rule 8D(2)(iii) the same is disallowable to the extent of 0.5% of average investment. The said disallowance is not justified and is liable to be deleted.”*

3. The Brief facts of the case are that assessee company is engaged in the business of manufacturing and dealing in flexible packaging material.

4. During the assessment proceedings u/s 143(3) read with section 143(2) of the Income Tax Act, 1961, the assessing officer noticed that the assessee company has received dividend of Rs. 48,925/- which was claimed as exempt income by the assessee company. The assessee company was asked to explain why the expenditure incurred and claimed in respect of the afore-stated exempt income should not be disallowed as per section 14A of The

Income Tax Act,1961 (Hereinafter called “the Act”) read with rule 8D of the Income Tax Rules, 1962 . The assessee company submitted that the assessee company has incurred interest expenditure for running of business requirement and not for earning exempt income and hence provisions of section 14A of the Act are not applicable. The Assessing Officer rejected the contention of the assessee company that interest free funds are being invested for making investments , rather the assessing officer held that substantial interest expenditure has been incurred by the assessee company. The assessing officer held that the assessee company has not furnished any fund flow statement highlighting that no interest bearing fund was utilized for making the investments, the income of which is exempt from tax with necessary supporting bank statements. The assessing officer held that the assessee company has made substantial investments in shares , the income of which is exempt and also the assessee company drastically increased its equity share holding in M/s Umax Packaging Ltd. from Rs. 8 crores to Rs. 19.37 crores during the assessment year which is an entity covered u/s 40A(2)(b) of the Act and the assessee company borrowings has also increased during the period on which interest paid is Rs. 1,39,21,886/-. The assessing officer held that the assessee company is engaged in the business of flexible packaging and is not an investment company and hence had the assessee company not made investments in shares , it would not have required borrowings on which the interest is paid by the assessee company because the assessee company has sufficient funds of its own to invest in its business. Thus, the assessing officer disallowed the expenditure to the extent of Rs. 42,43,553/- out of which Rs. 32,21,526/- is disallowed towards the interest expenditure and Rs. 7,22,027/- is disallowed towards the administrative expense at 0.5% of the average

investments after applying Section 14A of the Act read with rule 8D(2)(ii) and (iii) of Income Tax Rules,1962.

5. Aggrieved, the assessee company filed first appeal with the CIT (A) and submitted that the assessing officer has failed to bring any material on record to establish that any expenditure has been incurred by the assessee company to earn exempt income for the relevant assessment year particularly when the assessee company has denied having spent any expenditure for earning any exempt income. The assessee company submitted that it has total investments of Rs. 20.41 crores as at the end of the assessment year, and own funds consisting of equity capital and reserve and surplus is Rs. 41.64 crores as at the end of assessment year. The assessee company submitted that it has made investment of Rs 11.93 crores during the assessment year (including investment in 100% subsidiary company Umax Packaging Limited of Rs. 1123.42 lacs made during the assessment year) and it has used the proceeds of fresh share capital raised during the assessment year to the tune of Rs.9.86 crores and own reserves and surplus to the tune of Rs. 2.07 crores were utilised for making the afore-stated investment. The assessee company also submitted that it has borrowed money by way of following amounts outstanding as at year end which are utilized for the specific purpose for which the said loans were raised such as acquisition of fixed assets,book debts,stocks and car.

(a) Term Loans from Banks –Rs 2.01 crores- utilised for acquiring fixed assets

(b) Cash Credit Limit- Rs.10.16 crores –utilised for stocks and book debts

(c) Car Loan-Rs0.03 crores- utilised for acquiring car

(d) Unsecured loans

(i) interest bearing- NIL

(ii) Interest free- Rs.2.33 crores

Thus , the assessee company demonstrated before the CIT(A) that either it has its own fund to the tune of Rs. 41.64 cores or interest free unsecured loans to the tune of Rs. 2.33 crores which are utilized towards the investments in the share capital while interest bearing loans to the tune of Rs 12.20 crores were raised from the bank for specific purposes such as acquisition of fixed assets, car, book debts and stock and were , thereafter, utilised by the assessee company for the purposes for which the said interest bearing funds were raised by the assessee company from the bank and the assessee company stated that it is debarred from diverting bank loans for any other purpose other than for which the bank loans were raised . The assessee company submitted that the fund flow statements were duly submitted before the assessing officer and the assessing officer has wrongly stated that no fund flow statement was submitted before him.

The CIT(A) after considering the submission of the assessee company and the case laws relied upon by the assessee company deleted the addition made by the assessing officer towards disallowance of interest expenditure to the tune of Rs. 35,21,526/- after holding that the assessee company has its own funds to the tune of Rs. 41.64 crores which are sufficient to make investments of Rs.20.41 crores, further the CIT(A) held that the assessee company has given detailed purposes for which the interest bearing loans were raised by the assessee company from banks for specific purposes such as acquisition of fixed assets, book debt , stocks and car. The CIT(A) held that the assessing officer has no where pointed out any defect in the assessee company

submissions about utilisation of interest free funds for making investments and the assessing officer has not brought on record any cogent material to prove that interest bearing funds are utilised by the assessee company for making investments to the tune of Rs.20.41 crores. Thus, the CIT(A) allowed the appeal of the assessee company by allowing the interest expenditure to the tune of Rs.35,21,526/- which was earlier disallowed by the assessing officer.

6. Aggrieved by the order of CIT(A), the Revenue is in appeal before us.

7. Ld. DR relied upon the order of the assessing officer and contended that interest expenses of Rs.35,21,526/- are to be disallowed as the assessee company has made huge investment of Rs 20.41 crores in shares and mutual funds, the income of whom will be exempt from tax and hence on the same analogy expenses are to be disallowed as per mandate of Section 14A of the Act read with rule 8D(2)(ii) of the Income Tax Rules,1962.

8. The assessee company on the other hand reiterated its submissions made before the authorities below and relied upon the order of the CIT(A) . The assessee company also relied upon the orders of Delhi Bench of Tribunal in the case of Interglobe Enterprises Ltd. v. DCIT (2014) 40 CCH 022 and contended that the assessee company had utilized interest free funds to make investments . The assessee company submitted that the investment of Rs.19.37 crores out of total investment of Rs. 20.41 crores is in 100% subsidiary company Umax Packaging Limited which is a strategic investment. The assessee submitted that the assessing officer has failed to bring any material on record to establish that any expenditure has been incurred by the assessee company to earn exempt income for the relevant assessment year particularly when the assessee company has denied having spent any expenditure for

earning any exempt income. The assessee company submitted that it has total investments of Rs. 20.41 crores as at the end of the assessment year, and own funds consisting of equity capital and reserve and surplus is Rs. 41.64 crores as at the end of assessment year which is sufficient to make the investment. The assessee company submitted that it has made investment of Rs 11.93 crores during the assessment year (including investment in 100% subsidiary company Umax Packaging Limited of Rs. 1123.42 lacs) for which it has used the proceeds of fresh share capital raised during the assessment year to the tune of Rs.9.86 crores and own reserves and surplus to the tune of Rs. 2.07 crores were utilised for making the afore-stated investment. The assessee company also submitted that it has borrowed money by way of under-mentioned amounts as at year end which are utilized for the specific purpose for which the said loans were raised such as acquisition of fixed assets, book debts, stock and car.

(a) Term Loans from Banks –Rs 2.01 crores- The bank loan was utilised for acquiring fixed assets

(b) Cash Credit Limit- Rs.10.16 crores –The bank loan was utilised for stocks and book debts

(c) Car Loan-Rs0.03 crores- The bank loan was utilised for acquiring car

(d) Unsecured loans

(i) interest bearing- NIL

(ii) Interest free- Rs.2.33 crores

Thus , assessee company submitted that either it has its own fund to the tune of Rs. 41.64 cores or interest free unsecured loans to the tune of Rs. 2.33 crores which are utilized towards the investments in the share capital while

interest bearing loans to the tune of Rs 12.20 crores were raised from the bank and utilised by the assessee company for the purposes for which the said interest bearing funds were raised by the assessee company from the bank and the assessee company stated that it is debarred from diverting bank loans for any other purpose other than for which the bank loans were raised .

8. We have heard the rival submissions and perused the material on record. We have observed that assessee company has its own funds amounting to Rs. 41.64 crores and the investment are to the tune of Rs. 20.41 crores. We have also observed that assessee company has duly demonstrated that the interest bearing funds to the tune of Rs.12.20 crores on which the assessee company has paid interest have been raised from the banks towards the acquisition of fixed assets, car loan, book debts and stocks .The assessee company has also raised during the financial year , fresh equity capital of Rs. 9.86 crores and free reserve of Rs. 2.07 crores were utilised to make fresh investments of Rs. 11.93 crores during the assessment year. Thus , we hold that assessee has sufficient own funds to make investment and the assessee has also proved by cogent evidences that no interest bearing funds are utilized for making investments as the assessee company has demonstrated that the interest bearing funds are bank loans raised by the assessee company for specific purposes and also utilised for the said purposes from which diversion of fund is not permitted and hence the disallowance of the interest expenditure of Rs. 35,21,564/- under Ruled 8D2(ii) by the revenue is hereby deleted and order of the CIT(A) is upheld. Hence , the appeal of the Revenue is dismissed.

9. We will now dispose off the cross objection filed by the assessee company with respect to disallowance u/s 14A of the Act read with Rule 8D(2)(iii) of Income Tax Rules,1962 with respect to disallowance of Rs.7,21,989/- towards administrative and indirect expenses @0.5% of the average investments held by the assessee company.

10. The assessee company has raised the contention that the assessing officer has wrongly disallowed the administrative expenses at the rate of 0.5% on the average investments to the tune of Rs. 7,22,027/- by applying Section 14A read with rule 8D(2)(iii) of Income Tax Rules,1962. The assessee company submitted that it has not incurred any administrative or any other in-direct expenses for making or maintaining investment of Rs.20.41 crores. The assessee company relied upon the submissions made by it before the authorities below. The assessee company contended that investment of Rs.19.37 crores out of total investment of Rs.20.41 crores is in 100% subsidiary company M/s Umax Packaging Limited which is a strategic investment and hence no disallowance be made u/s 14A of the Act read with rule 8D(2)(iii) of Income Tax Rules,1962.

11. The Ld. DR on the other hand, relied upon the orders of authorities below.

12. We have considered the rival submissions and perused the material on record and case laws relied upon by the assessee company. We find that Section 14A of the Act read with Rule 8D(2)(iii) of the Income Tax Rules,1962 is applicable from the assessment year 2008-09 as held by the Hon'ble Bombay High Court in the case of Godrej & Boyce Mfg. Co. Ltd. 234 CTR 1. The assessee company has made average investments of Rs. 14.44 crores computed as per

rule 8D(2)(iii) of Income Tax Rules,1962 . The investments made by the assessee company includes the investment of Rs.19.37 crores made in 100% subsidiary company.

13. Coming to the submission of assessee that these are strategic investments and no disallowance made towards the administrative expenses. We would like to mention that under normal circumstances strategic investment are made for the purposes of doing business with a long term horizon and in that case no doubt that the objective is to earn profits/returns from the investment but **normally** the said profit / returns will come by way of dividend(s) when the companies come into profit and declare dividend to the shareholders . Such dividends in the hands of shareholders shall be exempt from tax. No doubt , the returns can also come by way of divestments of these investments but normally strategic investments are made with long term horizon where objective is to set up business and growth of these business over a long period of time. In these type of strategic investments, the investor has to normally devote significant time to plan, execute and monitor these investments regularly and periodically to ensure that these strategic investments are turned viable and profitable. These Investment decisions are very complex in nature. They require substantial market research, day-to-day analysis of market trends and decisions with regard to acquisition, retention and sale of shares at the most appropriate time. They require huge investment in shares and consequential blocking of funds. Besides, investment decisions are generally taken in the meetings of the Board of Directors / Shareholders for which administrative and management expenses are incurred and in some businesses regulatory approvals are required before setting up the same. There will be regular monitoring of these investments

which also may require participation in the meetings of committees, Board of Director and Shareholder meetings. There will definitely be an expenditure incurred towards administrative and management cost etc. towards planning, executing and maintaining these investments . Our view is fortified by the following decisions :

1. The observation made by Hon'ble Supreme Court in the case of CIT v. Walfort Share & Stock Brokers Pvt. Ltd. (2010) 326 ITR 1(SC) defining the scope of Section 14A of the Act incorporated retrospectively wef 1st April 1962. The relevant observations are reproduced as under:

“The insertion of section 14A with retrospective effect is the serious attempt on the part of the Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act against the taxable income (see Circular No. 14 of 2001 dated 22-11-2001). In other words, section 14A clarifies that expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income. In many cases the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of section 14A, the expenditure incurred in respect of exempt income was being claimed against taxable income. The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time avail the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The basic reason for insertion of section 14A is that certain incomes are not includible while computing total income as these are exempt under certain provisions of the Act. In the past, there have been cases in which deduction has been sought in respect of such incomes which in effect would mean that tax incentives to certain incomes

was being used to reduce the tax payable on the non-exempt income by debiting the expenses, incurred to earn the exempt income, against taxable income. The basic principle of taxation is to tax the net income, i.e., gross income minus the expenditure. On the same analogy the exemption is also in respect of net income. Expenses allowed can only be in respect of earning of taxable income. This is the purport of section 14A. In section 14A, the first phrase is "for the purposes of computing the total income under this Chapter" which makes it clear that various heads of income as prescribed under Chapter IV would fall within section 14A. The next phrase is, "in relation to income which does not form part of total income under the Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14A. Further, section 14 specifies five heads of income which are chargeable to tax. In order to be chargeable, an income has to be brought under one of the five heads. Sections 15 to 59 lay down the rules for computing income for the purpose of chargeability to tax under those heads. Sections 15 to 59 quantify the total income chargeable to tax. The permissible deductions enumerated in sections 15 to 59 are now to be allowed only with reference to income which is brought under one of the above heads and is chargeable to tax. If an income like dividend income is not a part of the total income, the expenditure/deduction though of the nature specified in sections 15 to 59 but related to the income not forming part of total income could not be allowed against other income includible in the total income for the purpose of chargeability to tax. The theory of apportionment of expenditures between taxable and non-taxable has, in principle, been now widened under section 14A. Reading section 14 in juxtaposition with sections 15 to 59, it is clear that the words "expenditure incurred" in section 14A refers to expenditure on rent,

taxes, salaries, interest, etc. in respect of which allowances are provided for (see sections 30 to 37).

2. The ITAT, Mumbai in the case of ACIT v. Citicorp Finance (India) Limited (2007)108 ITD 457 has negated the contention of the assessee that it had incurred no expenditure for earning high dividends as under:

“It is difficult to accept the hypothesis that one can earn substantial dividend income without incurring any expenses whatsoever including management or administrative expenses. By same logic, it is equally difficult to accept that the only expenses involved in earning the dividend income are those incurred on collection of dividend or on encashing a few dividend warrants. A company cannot earn dividend without its existence and management. Investment decisions are very complex in nature. They require substantial market research, day-to-day analysis of market trends and decisions with regard to acquisition, retention and sale of shares at the most appropriate time. They require huge investment in shares and consequential blocking of funds. It is well known that capital has cost and that element of cost is represented by interest. Besides, investment decisions are generally taken in the meetings of the Board of Directors for which administrative expenses are incurred. It is therefore not correct to say that dividend income can be earned by incurring no or nominal expenditure. This aspect of the matter has also received careful attention of Chennai Bench of this Tribunal in Southern Petro Chemical Industries v. Dy. CIT (2005) 3 SOT 157 (Chennai-Trib). After comprehensive consideration of all the relevant aspects of the case including the provisions of law, the Chennai Bench has held that investment decisions are very strategic decisions in which top management is involved and therefore proportionate management expenses are required to be deducted while computing the exempt income from dividend. In Harish Krishnakant Bhatt v. Income Tax Officer (2004) 91 ITD 311 (Ahd.), the Ahmedabad Bench of this Tribunal has held that, the dividend income being exempt under section 10(33), the interest on capital borrowed for acquisition of relevant shares yielding such dividend cannot be allowed deduction by operation of section 14A. In Dy. CIT v. SG Investments & Industries Ltd. (2004) 89 ITD 44 (Cal.), the Calcutta Bench of this Tribunal has laid down two propositions: one, in view of section 14A inserted in the Income Tax Act with retrospective effect from 1-4-1962, pro rata expenses on account of interest relatable to investment in shares for earning exempt income from dividend are to be disallowed against taxable income and only the net dividend income

is to be allowed exemption after deducting the expenses; and two, the expression "expenditure incurred by the assessee in relation to income which does not form part of the total income" in section 14A has to be given a wider meaning and would include both direct and indirect relationship between expenditure and exempt income. Following the decision of the Hon'ble Supreme Court in CIT v. United General Trust Ltd. (1993) 200 ITR 488 (SC), the Calcutta Bench of the Tribunal has also held that the interest paid by the assessee being attributable to the money borrowed for the purpose of making the investment which yielded the dividend and other expenses incurred in connection with or for making or earning the dividend income can be regarded as expenditure incurred in relation to dividend income. In Everplus Securities & Finance Ltd. v. Dy. CIT (2006) 101 ITD 151 (Del), the Delhi Bench of this Tribunal has held that merely because the assessee did not earn the dividend out of investment in certain shares does not imply that the provisions of section 14A would not apply to that extent. In Asstt. CIT v. Premier Consolidated Capital Trust (I). Ltd. (2004) 83 TTJ (Mum.) 843, the Mumbai Bench of this Tribunal has held that the assessing officer is justified in attributing a part of the financial and administrative expenses as expenditure incurred in relation to exempt income and disallowing the same in view of the provisions of section 14A."

3. The ITAT, Chennai Bench has held in the case of Southern Petro Chemicals Industries v. DCIT(2005) 3 SOT 157 as under:

" We have considered the rival submissions and perused the records of the case. Admittedly, these investments in shares were made during the course of the carrying on of business and as is evident from the records, substantial investments had been made by the assessee in earlier years, and during the current year as well the assessee made an investment of Rs. 19 crores. Whether to invest or not to invest and whether to retain the investments or to liquidate the same are very strategic decisions which the management is called upon to take. These are mind-boggling decisions and top management is involved in taking these decisions. This decision making process is very complicated and requires very careful analysis. Moreover, the assessee has to keep track of various dividend incomes declared by the investee companies and also to keep track of the dividend income having been regularly received by the assessee. This activity itself calls for considerable management attention and cannot be left to a junior clerk. The Hon'ble Supreme Court in the case of United General Trust Ltd. (supra), applying the decision of Hon'ble Supreme Court in the case of Distributors (Baroda) (P) Ltd. v. Union of India (1985) 47 CTR (SC) 349: (1985) [155 ITR 120](#) (SC), reversed the decision of the

Hon'ble Bombay High Court in CIT v. United General Trust (P) Ltd. (supra), wherein the question was as under:

"Whether, on the facts and in the circumstances of the case and in law, the Tribunal was justified in applying the decision of the Bombay High Court in the case of CIT v. New Great Insurance Co. Ltd. (1973) [90 ITR 348 \(Bom\)](#) to the assessment year in question without considering the effect of the amendment operative from 1st April, 1968, and in thus holding that the assessee would be entitled to the deduction under section 80M on the gross dividend before deduction of the proportionate management expenses?"

Thus, when the decision of the Honble Bombay High Court has been reversed, the proportionate management expenses are required to be deducted while computing the dividend income. In the decision of the Hon'ble Calcutta High Court, relied upon by the learned counsel for the assessee, Mr. Dastur, in the case of CIT v. United Collieries Ltd. (supra), it has been held that if the facts of a particular case so warrant, the allocation can be made towards expenses. In view of the aforementioned discussion and keeping in view the submissions of the learned Departmental Representative, we restore this matter to the assessing officer to verify the quantum of deduction claimed by the assessee in earlier years under section 57(i) from the dividend income (when it was taxable) and make a pro rata adjustment on the basis of subsequent investments made, inflation, etc. This ground is, accordingly, allowed for statistical purposes

4. The ITAT, Kolkatta Bench in recent reported judgment in Coal India Limited v. ACIT 2015 Tax Pub(DT)2496 in ITA No 1032/Kol/2012 pronounced recently on 13th May 2015 has categorically held that even strategic investment in group concerns for the purpose of control and not for earning dividend attract disallowance u/s 14A of the Act read with rule 8D of the Income Tax Rules, 1962.

Since the assessee company had claimed that no expenditure was incurred, the assessing authorities were correct to estimate the incurring of such expenditure under section 14A of the Act read with Rule 8D(2)(iii) of Income Tax Rules, 1962.

The assessing officer has disallowed by computing the indirect expenditure being administrative and other in-direct expenses after invoking Rule 8D(2) (iii) of Income Tax Rules ,1962.

We, therefore, hold that the assessing officer has rightly invoked the provisions of section 14A of the Act read with Rule 8D(2)(iii) of Income Tax Rules, 1962 for disallowing the expenditure of Rs. 7,22,027/- towards administrative and other indirect expenses which was affirmed by the CIT(A) and the same is also hereby affirm by us as we have found no infirmity in the orders of the authorities below. We order accordingly.

14. In the result appeal of the Revenue is dismissed and the Cross Objection of the assessee company is partly allowed.

Order pronounced in the open court on this 30th day of September 2015.

Sd/-

(Shailendra Kumar Yadav)
(Judicial Member)

Sd/-

(Ramit Kochar)
(Accountant Member)

Mumbai dated 30-09-2015