IN THE INCOME TAX APPELLATE TRIBUNAL
CHANDIGARH BENCHES 'B' CHANDIGARH

BEFORE SHRI H.L.KARWA, HON'BLE, VICE PRESIDENT AND
SHRI MEHAR SINGH, ACCOUNTANT MEMBER

ITA No. 16/Chd/2012
Assessment Year: 2008-09

The DCIT, Circle VII, Ludhiana	Vs	M/s Oswal Woollen Mills Ltd., Sherpur, Ludhiana PAN No. AAACO1973F
(Appellant)		(Respondent)

&

ITA No. 53/Chd/2012
Assessment Year: 2008-09

M/s Oswal Woollen Mills Ltd., Sherpur, Ludhiana Ludhiana PAN No. AAACO1973F	Vs	The Addl.CIT, Range VII, Ludhiana

Appellant By : Shri Akhilesh Gupta,
Respondent By : Shri Navdeep Sharma

Date of hearing : 02.03.2012
Date of Pronouncement : 06.03.2102

ORDER

PER H.L.KARWA, VP

These two appeals filed by the Revenue and assessee are directed against the order of CIT(A)-II, Ludhiana dated 9.11.2011 relating to assessment year 2008-09.

2. Firstly, we will take up Revenue's appeal i.e. ITA No.16/Chd/2012. Ground No.1 of the appeal reads as under:-

> 1. *On the facts and in the circumstances of the case, the Ld. CIT(A)-II Ludhiana has erred in allowing the expenses amounting to Rs. 33,895/- though relating to previous year but crystallized and paid during the year.*

3. The facts relating to this issue are that during the year under consideration the assessee company had paid expenses of Rs. 33,01,275/- in its various units which were related to earlier years. Out of the said amount claimed, the Assessing Officer disallowed and added Rs. 33,895/- by rejecting the contention of the assessee company. The Assessing Officer discussed this issue at pages 2 of 4 in para 1 of the assessment order.

4. On appeal, the CIT(A) deleted the addition for the reasons stated in para 3 of the impugned order, which reads as under:-

> "3. *I have carefully considered the submissions and arguments advanced by the Ld. A.R of the appellant company and perused the relevant documents produced before me. It was seen that Rs. 16,275/- on account of Trade Discount was decided to be paid during the year under appeal, though this trade discount was allowed at the sale made by the party M/s Vindh Traders, Lucknow, during the immediate preceding year. Since the liability was crystallized, determined and paid during the year under appeal, therefore, it is allowable during this year.*
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> *Similarly, the trade discount was determined and allowed to the party M/s Rohit Enterprises, Brailly, on the sales made by the said party in the preceding year. Since there was dispute which was settled during the year, therefore, it is an allowable during the year under consideration.*
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> *Regarding Cash Discount allowed by the appellant to M/s J. K. Sons, the dispute between the party and the*

appellant company arose. The party was claiming Cash discount on the payments made by M/s J. K. Sons to the appellant company on 30/6/2006. The said dispute was settled during the year and the appellant company allowed 7.5% Cash Discount on payment of Rs. 1,50 Lac, which comes to Rs.11,250/- and rightly claimed during the year under consideration. Therefore, it is allowable during the year only.

From the facts, documents and the arguments, the assessing officer is directed to allow the expenditure of Rs.33,895/-, being the liability crystallized and paid during the year under appeal. This ground of appeal is therefore allowed."

5. We have heard the rival submissions and have also perused the materials available on record. We find that a similar issue came up for consideration before 'A' Bench of the Tribunal in assessee's case in ITA No.1349/Chd/2011 relating to assessment year 2007-08. In that year, there was a dispute of Rs. 58,878/-. The Tribunal vide its order dated 27.12.2011 confirmed the order of CIT(A) stating that the expenditure of Rs. 58,878/- being the liability crystallized of earlier year and paid during the year under appeal is allowable expenditure. The order of the Tribunal referred to above is squarely applicable to the facts of the present year. Following the order of the Tribunal, we hold that CIT(A) was justified in directing the Assessing Officer to allow expenses which was crystallized and paid during the year, though related to earlier year. In view of the order of the Tribunal, we uphold the order of CIT(A) reproduced hereinabove. The ground No.1 is dismissed.

6. Ground No.2 of the appeal reads as under:-

2. On the facts and in the circumstances of the case, the Ld. CIT(A)-II, Ludhiana has erred in deleting the addition of Rs. 4,75,471/- on account of articles distributed among

business associates on various occasions for want of detail of persons to whom the gifts were distributed.

7. While framing the assessment, the Assessing Officer disallowed Rs. 4,75,471/- on account of articles distributed amongst business associates on various occasions including Diwali for want of the detail of persons whom gifts were distributed.

8. On appeal, the CIT(A) allowed the claim of the assessee following his own order passed in assessee's case for assessment year 2007-08.

9. After hearing the Ld. representatives of both the parties, we find that the issue is squarely covered in favour of the assessee and against the Revenue by the order of the Tribunal dated 27.12.2011 in ITA No.1349/Chd/2011 in assessee's case relating to assessment year 2007-08. While deciding a similar issue, the Tribunal in assessment year 2007-08 followed the order of ITAT Chandigarh Bench 'B' passed in assessee's case in ITA No. 594/Chd/2005 dated 26.5.2006 relating to assessment year 2001-02. The relevant findings given by the Tribunal in assessee's case in assessment year 2001-02 reads as under:-

"8 We have heard both the parties at length and carefully gone through the material available on record. In the present case it is not in dispute that the assessee distributed the gifts on the occasion of Diwali. The Assessing Officer while making the disallowance had considered that those expenses were not related to the business of the assessee. Similar issue had been decided by the Tribunal in ITA No. 895/Chandi/2000 in the case of DCIT C.C. V, Ludhiana V Nahar International Ltd, Ludhiana (Supra). In the detailed order dated 24.2.2005 in the aforesaid referred to case, ITAT Chandigarh Bench 'A' has held as under:

> *"16 We have considered the rival submissions and the material available on record. In the instant case, it is not in dispute that the expenses had been incurred by the assessee on the occasion of Diwali. The Assessing Officer disallowed 50% of expenses considering the same in the nature of entertainment on the basis that the assessee had not filed the details of persons to whom those gifts were delivered. No other basis had been given. In our opinion, the reasons given by the Assessing Officer in making the disallowance were not sufficient particularly when it is customary to incur such type of expenses on the occasion of Diwali. It is also noticed from the assessment order that the Assessing Officer had mentioned the names of the persons from whom the purchases were made. He also pointed out that few of the items were "shawl" which shows that vouchers/bills were available and those had been considered by the Assessing Officer. Therefore, it cannot be said that the expenses were not incurred by the assessee and the details of expenses were not available to the Assessing Officer."*
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> *We are of the view that the facts of assessee's case are similar to the facts involved in the case of Nahar International Ltd (Supra) so, respectfully following the earlier order of the Tribunal dated 24.2.2005 in the case of Nahar International Ltd (supra), we do not see any merit in this ground of departmental appeal."*

10. Respectfully following the order of the Tribunal passed in assessee's case referred to above, we dismiss the ground raised by the Revenue.

11. Ground No 3 of the appeal reads as under:-

> *3. On the facts and in the circumstances of the case, the Ld. CIT(A)-II Ludhiana has erred in deleting addition of Rs. 35,000/- made out of total expenditure of Rs. 91,032/- incurred on guest house.*

12. After hearing the Ld. representatives of both the parties, we find that the issue is squarely covered in favour of the assessee and against the Revenue by

the decision of this Bench of the Tribunal dated 27.12.2011 in assessee's case in ITA No.1349/Chd/2011 relating to assessment year 2007-08. The relevant findings of the Tribunal reads as under:-

> *"9. In Ground No.4, the Revenue challenged the deletion of addition of Rs.35,000/- made out of total expenditure of Rs.1,21,404/- incurred on Guest House. Ld. 'AR' placed reliance on CO No. 61/Chd/2004 for the assessment year 1999-2000 in the case of Nahar Industrial Enterprises. Before CIT(A), it was contended by the assessee that the impugned addition was made on surmises and conjectures and without bringing relevant material on record. Guest House expenses are allowable. Any adhoc disallowance, without any evidence, is not sustainable in the eyes of law. This is established proposition of law that addition cannot be made on surmises and conjectures. It should be founded on cogent and credible evidence. In the present case, we do not find any evidence brought on record by the AO to support his addition. Therefore, findings of the CIT(A) are upheld and this ground of appeal is dismissed."*

13. Respectfully following the order of the Tribunal (supra), we do not see any merit in this ground of appeal and dismiss the same.

14. Ground No.4 of the appeal reads as under:-

> *4. On the facts and in the circumstances of the case, the Ld. CIT(A)-II , Ludhiana has erred in deleting addition of Rs. 11,462/- on account of subscription expenses of club, or director and employees of the company.*

15. After hearing Ld. representatives of both the parties, we find that the issue is squarely covered in favour of the assessee and against the Revenue by the decision of this Bench of the Tribunal passed in assessee's case in ITA No.1349/Chd/2011 relating to assessment year 2007-08. The Tribunal vide its order dated 27.12.2011 held as under:-

> *"10. In Ground No.5, Revenue contended, that CIT(A) erred in deleting addition of Rs.15,458/- on account of subscription expenses of club, of Director and employees of the company. Ld. 'DR' placed reliance on the assessment order and ld. 'AR' placed reliance on the order or the CIT(A) and contended that the issue stands covered in its favour vide ITA No. 594/Chd/2005 (assessment year 2001-02) in assessee's own case.*
>
> *11. We have carefully perused the factual situation of the present case, the assessment order and the order passed by the Tribunal in assessee's own case and found that such expenses are admissible, hence, same are allowed. There is no infirmity in the order of the CIT(A), therefore, this ground of appeal of the Revenue is dismissed."*

16. Respectfully following the order of the Tribunal referred to above, we uphold the order and dismiss ground No.4 of the appeal.

17. Ground No.5 of the appeal reads as under:-

> *5. On the facts and in the circumstances of the case, the Ld. CIT(A)-II, Ludhiana erred in directing the Assessing Officer to allow expenditure of Rs. 4,04,791/- paid to ESI department being additional amount charged by ESI department for delay in depositing ESI payment.*

18. During the year under consideration, the assessee claimed Rs. 4,04,791/- paid to Employees State Insurance department, Chandigarh being the additional amount charged by ESI department for delay in deposing ESI payment. The Assessing Officer did not allow the claim of the assessee on the ground that the said amount was nothing but the penalty levied by ESI department.

19. On appeal, the CIT(A) allowed the claim of the assessee for the reasons stated in para 12 of the impugned order.

20. We have heard the rival submissions and have also perused the materials available on record. It is apparent from the record that the assessee company paid an amount of Rs. 4,04,791/- to ESI department on account of additional amount levied by ESI department, Chandigarh for delay in depositing ESI payment. The assessee claimed the said expenditure as Revenue in nature. Reliance was placed on the decision of the Hon'ble Supreme Court in the case of Prakash Cotton Mills P. Ltd v CIT (1993) 201 ITR 684. Shri Neeraj Sharma, Ld. Counsel for the assessee also relied upon another judgment of Hon'ble Supreme Court in the case of Standard Batteries Ltd v CIT (1995) 211 ITR 444 (SC). In these decisions, it has been held that any amount which is compensatory in nature is an allowable expenditure in respect of its nomenclature a penalty. Shri Neeraj Sharma, Ld. Counsel for the assessee further furnished a copy of order dated 1.1.2008 passed by Regional Officer, ESIC, Chandigarh under section 85(B) of the ESI Act, 1948. As per this order, the impugned amount paid by the assessee to ESI department is an additional amount for delay of payment on ESI charges. Since the particular amount of ESI was an allowable expenditure and was allowed by the Assessing Officer u/s 43B of the Act on actual basis, therefore, any amount over and above paid by the company for delay in the payment of the amount is nothing but compensation and is compensatory in nature. The Ld. CIT(A) has also categorically held that the impugned payment paid by the company to ESI department for delay in payments is nothing but compensation and is compensatory in nature. There is no material on record to controvert the categorical findings given by the CIT(A). In our view, the said amount is not a penalty but damages paid to ESI department and hence compensatory in

character. Thus, in view of the decisions of the Hon'ble Supreme Court referred to above, the impugned amount is to be allowed u/s 37(1) of the Income Tax Act. Accordingly, we uphold the order of CIT(A) and dismiss the ground raised by the Revenue.

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

22. Now we will take up assessee's appeal i.e. ITA No. 53/Chd/2012 relating to assessment year 2008-09.

23. Ground No.1 of the appeal reads as under:-

> 1. *That the Ld. CIT (A)-II erred in law and on facts in not deleting the addition of Rs. 1,00,6483/- made by the Ld. Assessing Officer u/s 14A of the Act by applying rule 8D for expenses alleged to have been incurred to earn dividend income. Directions may be given not to disallow any expenditure u/s 14A of the Act merely on surmises & conjectures in view of Hon'ble Jurisdictional High Court's decision in the case of CIT Vs HERO CYCLES LTD dated 4/11/2009 in ITA No. 331 of 2009.*
>
> *However without prejudice to the above submissions the Ld. CIT(A -II, Ludhiana has further erred in law and facts in not directing the Ld. Assessing Officer to make disallowance u/s 14A by disallowing some administrative expenses on proportionate basis which works out at Rs. 23,560/- as submitted by the humble appellant during the assessment proceedings on the basis of ITAT decision in earlier years.*

24. The Assessing Officer has discussed this issue in para 5 of the assessment order which reads as under:-

> *"5. <u>Disallowance u/s 14A</u>*
>
> *The company has made investment in shares from year to year. The total investment as on 31/3/2008 as shown in the*

balance sheet is at Rs. 13.39 Crore. The assessee has earned dividend income of Rs. 1893345/- on the said investment. The assessee was asked to compute the expenses incurred to earn the dividend income which has been claimed to be exempt u/s 10(34) of the Income Tax Act. The assessee was also asked to explain as to why the disallowance u/s 14A should not be made as per Rule 8D of the Income Tax Rules. In reply to the query the assessee filed its written reply dated 17/8/2010 which is reproduced as under

"During the year under consideration the assessee company has earned exempt income u/s 10(34) & 10(38) comprising of dividend income of Rs. 1893345/- and Long term Capital Gain of Rs.1499596/-. No expenses were incurred to earn the said dividend income. Also no collection charges were paid for the credit of dividend warrants as the warrants were sent for local clearing. The investment made during the year as well as in earlier year was made from current accruals, reserves and surplus available with the company. Your kind self would appreciate that sufficient funds in the form of reserves were available with the company to make the investments. Since no amount was borrowed for the purpose of making investments, therefore neither interest nor any other expenditure out of Administrative expenses can be disallowed u/s 14A of the Act.

However, without prejudice to the above submissions if at all some expenses are attributable for earning the said dividend income of Rs. 1893345/- the same principle for computing such amount as laid down by the Hon'ble ITAT in CONO 17/2001 for Asstt. Year 1997-98 in case of Nahar Industrial Enterprises Ltd one of the group company and also followed by your predecessor in Assessment proceedings for Asstt. Year 2006-07 are worked out as under.

Disallwoance u/s 14-A *(Amount in Rs.)*

	In case u/s 115HB	*In case of regular computation*
1.LONG TERM CAPITAL GAIN	*0*	*14,99,596*
2.AMOUNT OF DIVIDEND INCOEM	*18,93,345*	*18,93,345*
	18,93,345	*32,92.941*

3.OPERATING INCOME	*442,46,11,707*	*442,46,11,707*
4. %OF DIVIDEND INCOME	*0.04*	*0.08*
5. AMOUNT OF EXPENSES OUT ADMINISTRATIVE EXPRESES	*2,90,74,500*	*2,90,74,550*
6.PROPORIONATE AMOUNT OF DISALLOWANCE OF ADMINISTRATIVE EXPNSES TO EARN DIVIDEND INCOME	*11,630*	*23,560*

Administrative Expenses

1.Managerial remuneration	*1,86,25,000*
2.Cost audit	*66,410*
3.Auditors remuneration	*5,37,369*
4. Directors Meeting fee	*1,00,000*
5. Postage, Telegram & Telephone	*60,77,101*
6.Printing & Stationery	*33,68,670*
	2,90,74,550

After going through the submissions it is found that the assessee has computed the disallowance on the basis of earlier year disallowance made in accordance with the order of the Income Tax appellate Tribunal in the case of group company M/s Nahar Industrial Enterprises Ltd. However, since the rule 8D has come into existence and is applicable in the year under consideration, therefore the disallowance under rule 8D is computed at Rs. 1030043/- which is as under:

Disallowance u/s 14A as per rule 8-D

1. *Expenses directly relatable to income which does not form part* *NIL*

of total income

2. *Income where assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt.*

Interest 14871450 x 125099353 Avg Value of Investment	*404546*
4598751517 Avg. Value of Total Assets	
3. *The amount of half percent of average value of investment 0.5% of Rs. 125099353 from which exempt income arose.*	*625497*
	1030043
Less: already added back	*23560*
	1006483

Accordingly, the addition of Rs. 1006483/- is made to the total income of the assessee company. Though the assessee has computed the disallowance u/s 14A at Rs. 235607- in its return on the basis of Hon'ble ITAT in group company case M/s Nahar Industrial Enterprises Ltd, but during the year under consideration disallowable u/s 14A has to be computed as per Rule 8-D of the Income Tax Rules as discussed above."

25. On appeal, the CIT(A) upheld the order of Assessing Officer for the reasons stated in para 9 to 10 of the impugned order.

26. Sh Navdeep Sharma, Ld. Counsel for the assessee vehemently argued that Assessing Officer was not justified in applying Rule 8-D of the Income Tax Rules, 1962 and thereby making a disallowance of Rs. 10,06,483/- u/s 14A of the Income Tax Act, 1961(in short 'the Act'),without assuming the proper jurisdiction and in view of the fact that the assessee itself disallowed Rs. 23,560/- in its return on proportionate basis once such claim was made by the assessee. The Assessing Officer was required to apply his mind to the plea of the assessee.He further submitted that the Assessing Officer was also expected to give findings that he is not satisfied with the corrections of the claim made by the assessee. Sh Navdeep Sharma Ld. Counsel for the assessee further submitted that the Assessing Officer is also expected to spell out the reasons

as to why the claim made by the assessee can not be accepted. It is after doing so that Assessing Officer can resort to the provisions of Rule 8-D of the Income Tax Rules. Reliance was placed on the following decisions:-

i) Multi Commodity Exchange of India ltd v DCIT (ITA No. 1050/Mumbai/2010 – AY 2008-09) order dated 5.8.2011

ii) Balarampur Chini Mills Ltd v DCIT (140 TTJ 73) (ITA No. 504/Kol/2011 AY 2008-09) – order dated 29.7.2011

iii) DCIT v Jindal Photo Ltd (ITA No. 814/Del/2011, AY : 2008-09) -order dated 23.9.2011

27. In view of the above decisions, Shri Naveep Sharma, Ld. Counsel for the assessee submitted that the order of CIT(A) on this issue may be set aside and the issue may be remanded to the Assessing Officer for fresh consideration.

28. Shri Akhilesh Gupta, Ld. DR strongly supported the orders of the lower authorities and submitted that the decisions relied upon by Shri Navdeep Sharma, Ld. Counsel for the assessee are not applicable to the facts of the present case.

29. We have heard the rival submissions and have also perused the materials available on record. The decision relied upon by the Ld. Counsel for the assessee were duly considered.

30. In the case of Multi Commodity Exchange of India ltd v DCIT (supra), the ITAT Mumbai Bench held as under:-

> *"9. We have heard the submissions of the Id. counsel for the assessee, who submitted that the AO was not justified in applying Rule 8D of the Income Tax Rules. In this regard the Id. counsel*

for the assessee drew our attention to the provisions of section 14A(2) of the Act and submitted that assessee had claimed before the AO that only a sum of Rs. 6,03,821/- can be considered as expenses incurred by the assessee in relation to income which does not form part of the total income under the Act. When such claim is made by the assessee the AO was required to apply his mind to the plea of the assessee. He was also expected to give a finding that he is not satisfied with the correctness of the claim made by the assessee. The AO also expected to spell out the reasons as to why the claim made by the assessee cannot be accepted. It is only after doing so that the AO can resort to the provisions of Rule 8D of the Rules. In this regard out attention was also drawn to the decision of the Hon'ble Bombay High Court in the case of Godrej Boyce Manufacturing Co. Ltd., 328 ITR 81 (Bom), wherein the Bombay High Court has laid down that Rule 8D can be invoked only if the AO rejects the correctness of the claim made by the assessee regarding expenses incurred in relation to income which does not form part of the total income under the Act. In other respects ld. counsel for the assessee reiterated the submissions made before the revenue authorities.

10. The Id. D.R submitted that the very fact that the AO invoked the provisions of Rule 8D of the Rules only implies that he was not satisfied with the claim of the assessee with regard to the expenses incurred in earning the exempt income. In other words, it was submitted by the Id. D,R that the satisfaction of the AO is implied. On merits it was submitted that the AO has rightly applied Rule 8D of the rules and the assessee cannot have any grievance.

11. We have considered the rival submission. The Hon'ble Bombay High Court in INCOME TAX APPEAL NO.626 OF 2010 in the case of Godrej and Boyce Mfg. Co.Ltd. Mumbai. vs. Dy. Commissioner of Income Tax, Range 10(2),Mumbai and Anr. 328 ITR 81 (Bom) has held as follows:

> *"Insertion of Subsections (2) and (3) to Section 14A:*
>
> *25. Subsections (2) and (3) of Section 14A were inserted by an amendment brought about by the Finance Act of 2006 with effect from 1 April 2007. Subsections (2) and (3) provide as follows:*
>
> *"14A(2) 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 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 this Act.

(3) The provisions of subsection (2) shall also apply in relation to a case where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under this Act:

Provided that nothing contained in this section shall empower the Assessing Officer either to reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under Section 154 for any assessment year beginning on or before the 1st day of April, 2001."

(The proviso was inserted earlier by the Finance Act of 2002 with retrospective effect from 11.5.2001)

Under subsection (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. The method, having regard to the meaning of the expression 'prescribed[1] in Section 2(33), must be prescribed by rules made under the Act. What merits emphasis is that the jurisdiction of the Assessing Officer to determine the expenditure incurred in relation to such income which does not form part of the total income, in accordance with the prescribed method, arises if the Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of the expenditure which the assessee claims to have incurred in relation to income which does not part of the total income. Moreover, the satisfaction of the Assessing Officer has to be arrived at, having regard to the accounts of the assessee. Hence, Sub section (2) does not ipso facto enable the Assessing Officer to apply the method prescribed by the rules straightaway without considering whether the claim made by the assessee in respect of the expenditure incurred in relation to income which does not form part of the total income is correct. The Assessing Officer must, in the first instance, determine whether the claim of the assessee in that regard is correct and the determination must be made having regard to the accounts of the assessee. The satisfaction of the Assessing Officer must be arrived at on an objective basis. It is only when the Assessing Officer Is not satisfied with the claim of the assessee, that the legislature directs him to follow the method that may be prescribed. In a situation where the accounts of the assessee furnish an objective basis for the Assessing Officer to arrive at a satisfaction in regard to the correctness of the claim of the assessee of the expenditure which has been incurred in relation to income which does not form part of the total income, there would be no warrant for taking recourse to the method prescribed by the rules. For, it is only in the event of the Assessing Officer not being so satisfied that recourse to the prescribed method is mandated by

law. Sub section (3) of Section 14A provides for the application of sub section (2) also to a situation where the assessee claims that no expenditure has been incurred by him in relation to income which does not form part of the total income under the Act. Under the proviso, it has been stipulated that nothing in the section will empower the Assessing Officer, for an Assessment Year beginning on or before 1 April 2001 either to reassess under Section 147 or pass an order enhancing the assessment or reducing the refund already made or otherwise increasing the liability of the assessee under Section 26. The circumstances in which the provisions of sub sections (2) and (3) were introduced by an amendment have been adverted to in a circular of the CBDT dated 28 December 2006. (Circular 14 of 2006) The circular notes that in the existing provisions of Section 14A no method for computing the expenditure incurred in relation to income which does not form part of the total income had been provided. As a result there was a considerable dispute between tax payers and the Revenue on the method of determining such expenditure. In this background, sub section (2) was inserted so as to make it mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to income which does not form part of the total income in accordance with the method that may be prescribed. The circular, however, reiterates that the Assessing Officer has to follow the prescribed method if he is not satisfied with the correctness of the claim of the assessee having regard to the accounts of the assessee.' (underlining by us for emphasis)

12. It is clear from the observations of the Hon'ble Bombay High Court referred to above that the application of Rule 8D of the Rules is not automatic. When the assessee makes the claim regarding the quantum of expenses to be disallowed in terms of section 14A of the Act, it was incumbent on the part of the AO to consider the claim of the assessee. It is only when the AO is not satisfied with the claim of the assessee he can have recourse with the provisions of Rule 8D of the Income Tax Rules. The satisfaction that the claim made by the assessee regarding expenses incurred in relation to the income which does not form part of the total income under the Act, is not correct, has to be arrived at by the AO, on an objective basis. In the present case, we find that the AO has proceeded to apply Rule 8D without giving any finding with regard to the correctness of the claim made by the assessee regarding the disallowance to be made under section 14A of the Act. The CIT(A) has also proceeded on the same basis. We are, therefore, of the view that the orders of the CIT(A) has to be set aside and the issue should be remanded to the AO for fresh consideration. The AO will consider the claim of the assessee with regard to the disallowance to be made under section 14A of the Act in the light of the decision of the Hon'ble Bombay High Court referred to above. The AO will decide the issue after affording the assessee opportunity of being heard. For statistical purposes the

appeal of the assessee is treated as allowed."

31. From the above decisions, it is clear that the application of Rule 8-D of I.T. Rules, 1962 is not automatic. Further, it is also clear that when the assessee makes the claim regarding the quantum of expenses to be disallowed in terms of section 14A of the Act, it is duty of the Assessing Officer to consider the claim of the assessee. It is only when the Assessing Officer is not satisfied with the claim of the assessee, he can have recourse with the provisions of Rule 8-D of the Income Tax Rules, 1962. Further, it is also clear that the satisfaction that the claim made by the assessee regarding expenses incurred in relation to the income which does not form part of total income under the Act is not correct, has to be a arrived at by Assessing Officer on objective basis. In the instant case, it is apparent from the records that the Assessing Officer proceeded to apply Rule 8-D without giving any findings with regard to the correctness of the claim made by the assessee regarding disallowance made u/s 14A of the Act. The CIT(A) has also proceeded on the same basis.

32. In the case of Balarampur Chini Mills Ltd v DCIT (supra), ITAT Kolkata Bench of the Tribunal held as under:-

> *".....From r. 8D of the Rules, it is clear that the AO can invoke this rule in case he is not satisfied with regard to the account of assessee that the claim of expenditure made by assessee is not correct and. the claim made by assessee that no expenditure has been made in relation to income which does not form part of total income under the Act, he shall determine the amount of expenditure in relation to such income in accordance with the provisions of r. 8D(2) of the Rules. Even the provisions of s. 14A(2) clearly state that the AO shall determine the amount of expenditure incurred in relation to such income which does not form part of total income under this Act in accordance with such method as prescribed (under r. 8D of the Rules), if the AO*

having regard to the account 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 total income under the provisions of this Act."

33. Neither the Assessing Officer nor CIT(A) has recorded any findings that having regard to the account of the assessee, they are not satisfied with the correctness of the claim of expenditure made by the assessee or the claim made by the assessee that no expenditure has been incurred in relation to the income which does not form part of the total income under the Act for the relevant assessment year. In the instant case also, neither the Assessing Officer nor CIT(A) has recorded any findings that having regard to the account of the assessee that they are not satisfied with the correctness of the claim of expenses made by the assessee.

34. In the case of DCIT v Jindal Photo Ltd (supra), the ITAT Delhi Bench of the Tribunal held as under:-

"14. In the year under consideration, it is seen that it is not incorrect when the assessee contends that no satisfaction has been recorded by the AO regarding the assessee's calculation being incorrect. Even so, Rule 8D of the Rules has been applied. This, in our opinion, is not correct. Such satisfaction of the AO is a pre-requisite to invoke the provisions of Rule 8D of the Rules. The Id. CIT (A), therefore, erred in partially approving the action of the AO."

35. From the above decisions, it is clear that the satisfaction of the claim made by the Assessing Officer regarding the expenses incurred in relation to the income does not form total income under the Act, is not correct, is to be arrived at by the Assessing Officer on objective basis. Both the authorities below have not recorded any findings that having regard to the account of the assessee they are not satisfied with the correctness of the claim of the

expenditure made by the assessee that no expenditure had been incurred in relation to income which does not form part of the total income under the Act for the assessment year under consideration. In the absence of any findings, we are of the view that the order of the CIT(A) deserves to be set aside. We order accordingly and remand the issue to the Assessing Officer for fresh decision in accordance with law after affording a reasonable opportunity of being heard to the assessee. Ground No.1 of the assessee's appeal is allowed for statistical purposes.

36. Ground No. 2 of the appeal reads as under:-

> *2. That the Ld. CIT(A)-II erred in law and on facts in upholding the decision of Ld. Assessing Officer for capitalizing interest of Rs. 178549/- paid on term loan for its existing business and not for extension of business. Directions may be given not to treat the said interest as capital expenditure and further to allow the said amount of interest of Rs. 178549/- as revenue expenditure.*

37. At the time of hearing of the appeal, Shri Navdeep Sharma, Ld. Counsel for the assessee did not press for this ground of appeal and accordingly we dismiss the same as not pressed.

38. In the result, Revenue's appeal i.e. ITA No. 16/Chd/2012 is dismissed while assessee's appeal i.e ITA No. 53/Chd/2012 is allowed partly for statistical purposes.

Order Pronounced in the Open Court on this 6th day of March, 2012

Sd/-	Sd/-
(MEHAR SINGH)	**(H.L.KARWA)**
ACCOUNTANT MEMBER	**VICE PRESIDENT**

Dated : 6th March, 2012
Rkk

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The CIT*
4. *The CIT(A)*
5. *The DR*

True Copy

By Order

Assistant Registrar

JINDAL Tribunal ORDER

“13. The Tribunal (supra), for assessment year 2007-08, had held as follows:-

2.

"17. We have heard the parties on this issue and have perused the material on record. During the year, the assessee had earned exempt dividend income of Rs.17,97,010/- in respect of investment made in mutual funds. In the return of income filed, a suo moto disallowance of expenses to the tune of Rs.1,73,038/- had been made by the assessee u/s 14A of the Act. In the assessment order, the AO made a disallowance of Rs.32,18,475/- by applying the method provided in Rule 8D of the I.T. Rules, 1962. This was done without pointing out any inaccuracy in the method of apportionment or allocation of expenses, as adopted by the assessee. All through, the assessee was maintained that the assessee was during the year, carrying on manufacturing activities at its manufacturing units at several places. Its head office was at Delhi. The assessee had maintained separate books of account for each unit. Common expenses incurred at the head office and the branches were attributed to all the units including the head office. Investment in mutual funds, which gave rise to exempt dividend income, was done through the head office. It was the case of the assessee that to earn such dividend income, no direct expenditure was required and no expenses were incurred to make investment of surplus amounts in mutual funds. The suo moto disallowance had, however, been made by the assessee keeping in consideration, the provisions of section 14A of the Act.

18. Now, as per section 14A(2) of the Act, if the AO, having regard to the accounts of the assessee, 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 assessee's total income under the Act, the AO shall determine the amount incurred in relation to such income, in accordance with such method as may be prescribed, i.e., under Rule 8D of the I.T. Rules. However, in the present case, the assessment order does not evince any such satisfaction of the AO regarding the correctness of the claim of the assessee. As such, Rule 8D of the Rules was not appropriately applied by the AO as correctly held by the CIT(A). It has not been shown by the AO that any expenditure had been incurred by the assessee for earning its dividend income. Merely, an ad hoc disallowance was made. The onus was on the AO to establish any such expenditure . This onus has not been discharged. In "CIT v. Hero Cycles" (PandH) 323 FTR 518, under similar circumstances, it was held that the disallowance u/s 14A of the Act requires a clear finding of incurring of expenditure

and that no disallowance can be made on the basis of presumptions in "ACIT v. Eicher Ltd." 101 TTJ (Del)369, that it was held that the burden is on the AO to establish nexus of expenses incurred with the earning of exempt income before making any disallowance u/s 14A of the Act. In "Maruti Udyog v. DCIT" 92 ITD 119(Del), it has been held that before making any disallowance u/s 14A of the Act, the onus to establish the nexus of the same with the exempt income, is on the revenue. In "Wimco Seedlings Limited v. DCIT" 107 ITD 267 (Del) (TM), it has been held that there can be no presumption that the assessee must have incurred expenditure to earn tax free income. Similar are the decisions in:

1.Punjab National Bank v. DCIT, 103 TTJ 908(Del);

2.Vidyut Investment Ltd., 10 SOT 284(Del); and

3.D.J. Mehta v. ITO, 290 ITR 238(Mum.)(AT).

19. In view of the above, finding no error with the order of the CfT(A) on the point at issue, the same is hereby confirmed. Ground No.3 is thus rejected."