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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No. 548/2015**

Reserved on: 1st August, 2017
Decided on: 23rd August, 2017

H.T. MEDIA LIMITED ..... Appellant
Through: Mr. Ajay Vohra, Senior Advocate with Mr. V.P. Gupta and Mr. Arunav Kumar, Advocates.

versus

PRINCIPAL COMMISSIONER OF INCOME TAX-IV, NEW DELHI ..... Respondent
Through: Mr. Raghvendra Singh and Mr. Rajesh Manchanda, Senior Standing counsel

AND

\+ **ITA No. 549/2015**

H.T. MEDIA LIMITED ..... Appellant
Through: Mr. Ajay Vohra, Senior Advocate with Mr. V.P. Gupta and Mr. Arunav Kumar, Advocates.

versus

PRINCIPAL COMMISSIONER OF INCOME TAX-IV, NEW DELHI ..... Respondent
Through: Mr. Raghvendra Singh and Mr. Rajesh Manchanda, Senior Standing counsel.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE PRATHIBA M. SINGH

J U D G M E N T

% 23.08.2017

Dr. S. Muralidhar, J.:

1. These are two appeals by the Assessee, H.T. Media Limited, under Section 260 A of the Income Tax Act, 1961 ('Act') against the common order dated 18th March 2015 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA Nos. 340 and 986/Del/2012 for the Assessment Year ('AY') 2008-09.

Questions of law

2. While admitting ITA No. 548 of 2015 on 15th October 2015, the following question was framed for consideration:

> "Whether the ITAT erred in remitting the matter concerning the deletion of disallowance of interest under clause (ii) of Rule 8 D (2) of the Income Tax Rules, 1962 to the Assessing Officer for a fresh determination in light of the decision of this Court in ***CIT v. Taikisha Engineering India Ltd. (2015) 370 ITR 338 (Del)***?"

3. While admitting ITA No. 549 of 2015 on 15th October 2015, the following question was framed for consideration:

> "Whether the Assessing Officer recorded a proper satisfaction in terms of Section 14A (2) and Rule 8 (D) of the Income Tax Rules, 1962 and, in calculating the disallowance at 0.5% of average value of investments as per clause (iii) of Rule 8 D (2) of the Income Tax Rules, 1962?"

4. The Appellant-Assessee is engaged in the business of printing and publishing newspapers and periodicals. For the AY in question, the Assessee filed its return on 30th September 2008 declaring a total income of Rs. 1,61,78,06,133/-. Thereafter, it filed a revised return on 30th March 2010 declaring a total income of Rs. 1,60,96,08,330/-.

Proceedings before the Assessing Officer

5. The return was picked up for scrutiny and notice was issued by the Assessing Officer ('AO') to the Assessee under Section 143 (2) of the Act on 4th August 2009. Due to a change in AO, another notice under Section 143(2) of the Act, along with a questionnaire under Section 142 (1) of the Act, was issued to the Assessee on 12th July 2010.

6. During the AY in question, the Assessee had made certain investments in shares/mutual funds/bonds etc. The Assessee received dividend income of Rs.2,94,38,025 from mutual funds which was claimed as exemption under Section 10 (35) of the Act. In response to the questionnaire issued by the AO, the Assessee stated, by way of its letter dated 15th November 2011, that all the investments from which dividend was received had been made by it out of its own funds and no borrowed funds had been utilized for the purpose. Accordingly, no interest expenditure had been incurred in relation to earning of exempt income.

7. Furthermore, in regard to the administrative expenses, it was submitted that the income had been earned on units of mutual funds.

There were only nineteen entries during the year. It was stated that investments of the Assessee were under the reinvestment schemes. Accordingly, no day-to-day activity was involved in relation to earning of exempt income. Income had been reinvested and accounting entries had been passed in the books of account only on redemption or switching over to another scheme. Nevertheless, the Assessee had made disallowance of Rs. 3 lakhs in the return of income in order to cover administrative expenses which are said to have been incurred in relation to earning of exempt income.

8. In the assessment order dated 27th December 2010, the AO held that, from the three clauses of Rule 8D of the Income Tax Rules, 1962 ('Rules'), "it clearly emerges that the stipulation of the provision is to compute the amount of expenditure which is not allowable under Section 14A of the Act as is relatable to the exempt income and not in considering all the expenses one by one for ascertaining if either of them have resulted into exempt income and thereafter considering such amount as disallowable under Section 14A." The AO referred to the decision of the Bombay High Court in ***Godrej and Boyce Mfg. Co. Ltd. v. CIT [2010] 328 ITR 81 (Bom)***.

9. It was further observed that making of investment, maintaining or continuing investment, and time of exit from investment are well informed and well coordinated management decisions involving not only inputs from various sources but also acumen of senior management functionaries. Therefore, cost is inbuilt into even the so

called 'passive' investments. There are incidental expenses of collection, telephone, follow-up, research etc. Therefore, expenses in relation to earning of income are embedded in direct expenses. The AO, accordingly, held that the Assessee had incurred expenses to manage its investments and had failed to calculate such expenses in a reasonable manner to ascertain the true and correct picture of its income. The AO computed the total disallowance under Rule 8D (2) as Rs.8,97,49,579/- comprising Rs.3 lakhs being the amount of expenditure directly incurred relating to exempt income under clause (i) of Rule 8D (2); Rs.6,86,27,884/- being the interest expenditure incurred under clause (ii) of Rule 8D (2); and Rs.2,08,21,695/-, being the amount equal to 0.5% of the average value of investments under clause (iii) of Rule 8D (2).

Order of the CIT (A)

10. The Assessee went in appeal before the Commissioner of Income Tax (Appeals) ['CIT (A)']. By the order dated 15th December 2011, the CIT (A) held that the documents placed on record by the Assessee showed that the term loan taken from State Bank of India (SBI) had been utilized for repayment of earlier loans. It could not be said that any amount of the term loan had been utilized for making investment. The CIT (A) further noted the submission of the Assessee that the deposits accepted at various units of the company from vendors and transporters for security had no relationship with the investments made by the corporate office of the company. The interest earned thereon was, thus,

not relatable to the exempt income. The interest payment made to Deutsche Bank was not for any loan utilised for making investments. The interest payments made to ABN Amro Bank and Citibank related to the debit balances in the current accounts with them. They were not relatable to investments made by the company. The Assessee contended that even if *pro rata* interest out of the above was considered as relatable to exempt income, such expenditure would be covered within the amount of Rs. 3 lakhs offered by the Assessee as disallowance.

11. As regards disallowances on account of administrative expenses, the CIT (A) declined to follow the order earlier issued for the AY 2005-06. It was held that, for AY 2008-09, the AO was bound to apply Rule 8D of the Rules. The CIT (A) held that the AO was justified in determining the administrative cost at 0.5% of the average value of the investments. Accordingly, disallowance of expenses to the tune of Rs.2,08,21,695/- was held to be justified. However, the CIT (A) deleted the disallowance of the interest amount of Rs.6,86,27,884/- on the basis that no term loan had been utilized for making investments.

Impugned order of the ITAT

12. Both the Assessee and the Revenue went in appeal before the ITAT against the above order of the CIT (A). By the impugned order, dated 18th March 2015, the ITAT reversed the order of the CIT (A) as regards disallowance of interest amount and remanded the matter to the AO for a fresh determination. It negatived the plea of the Assessee that the AO had not recorded his satisfaction about the incorrectness of the claim

made by the Assessee about no interest expenditure having been recorded. The ITAT held that in view of the decision of this Court in ***CIT v. Taikisha Engineering India Limited (2015) 370 ITR 338 (Del)***, the disallowance on account of interest could not be deleted simply on the ground that the Assessee's own capital and interest free funds were more than the funds invested in securities yielding exempt income. The ITAT held that reasoning given by it in the immediate preceding year, i.e., AY 2007-08 for deleting such disallowance under Section 14A could not be applied from AY 2008-09 onwards, when Rule 8D had come into force. It was held that the ends of justice would be adequately met if the impugned order on this issue was set aside and the matter restored to the file of AO for deciding this aspect afresh.

13. As regards the administrative expenses, again it was held that once Rule 8D had come into force the disallowance was required to be computed with reference to mandate of Rule 8D (iii). The CIT (A) had sustained the disallowance under clause (iii) of Rule 8D (2) of the Rules at 0.5% of the average of the value of investment, which amount was obviously much less than the actual expenditure incurred and claimed as deduction by the Assessee. The said disallowance could not be further reduced "to a lower level on an *ad hocism.*" The disallowance of Rs.2,08,21,695 as directed by the AO was accordingly upheld.

14. However the ITAT reversed the order of the AO to the extent that Rs. 3 lakhs already disallowed by the Assessee was once again disallowed by the AO. The ITAT further noted that during the AY in

question, the Assessee had earned a total exempt income of Rs. 2.94 crore whereas the disallowance made by the AO stood at Rs. 8.97 crore. In light of the law explained in ***CIT v. Holcim India Pvt. Ltd. (2014) 90 CCH 681 (Del),*** the disallowance under Section 14A could not exceed the amount of exempt income. Accordingly the ITAT directed the AO to take the ratio of the said decision into consideration while computing finally disallowable amount under Section 14A of the Act.

Assessee's application before the ITAT

15. An application was filed by the Assessee before the ITAT under Section 254 of the Act for rectification of the impugned order. It was pointed out that the impugned order of the ITAT had wrongly recorded that the CIT (A) had deleted the addition since the Assessee's own capital and interest free funds were more than the investments in securities yielding exempt income. The Assessee pointed out that the CIT (A) ordered the deletion on the basis of a factual holding that no interest bearing funds were utilized by the Assessee during the AY in question for the investments that yielded exempt income. Accordingly, it was prayed that the order of the ITAT be rectified.

16. The above application was dismissed by an order dated 4th December 2015 of the ITAT. The ITAT noted that upon perusal of Schedule 6 of the Annual Accounts of the Assessee for the relevant AY, "it transpires that some of such Investments in securities have been made fresh during the year under consideration alone." Therefore, the ITAT disregarded the contention of the Authorized Representative

('AR') of the Assessee that the investment in such securities were made in the earlier years which have been accepted by the ITAT to be from non-interest bearing funds. It was held that no mistake had crept into the impugned order which would warrant rectification under Section 254 (2) of the Act.

17. It requires to be recalled at this stage that the Assessee has filed two appeals against the impugned order of the ITAT for the AY in question. ITA No. 548 of 2015 pertains to disallowance of interest expenditure incurred to earn exempt income and ITA No. 549 of 2015 pertains to disallowance on account of administrative expenses.

Submissions on behalf of the Assessee

18. Mr. Ajay Vohra, learned Senior counsel appearing for the Assessee, first took up the issue of disallowance of expenditure incurred to earn exempt income under Section 14A of the Act on account of interest. Mr. Vohra pointed out that, despite the Assessee explaining in detail in its letter dated 15th November 2010 addressed to the AO that no interest bearing funds had been utilised for making investments during the AY in question, the AO failed to consider the said submissions in the assessment order dated 27th December 2010. The factual finding of the CIT (A) that no loans had been utilized for the purpose of investments and that the position for the AY in question was no different from AYs 2005-06, 2006-07 and 2007-08 was not found to be incorrect by the ITAT.

19. Mr. Vohra further pointed out that the ITAT had erred in recording that the Assessee had contended that its own funds were more than the investments and, therefore, there should be no disallowance under Section 14 A of the Act. In fact the Assessee's contention, which was accepted by the CIT (A), was that during the AY in question no interest bearing funds had been utilised for making investments.

20. Mr. Vohra submitted that the ITAT had also wrongly understood and applied the ratio of decision of this Court in ***CIT v. Taikisha Engineering India Limited*** *(supra)*. Even in that decision, this Court had emphasized that the AO was required to examine first "whether the Assessee had incurred expenditure by way of interest in the previous year, and secondly, whether interest paid was directly attributable to a particular income or receipt." In case the interest paid was directly attributable to any particular income or receipt, then the interest on loan amount to this extent or in entirety as the case may be, "has to be excluded for making computation as per the formula prescribed." Reliance was placed on the decision in ***Principal Commissioner of Income Tax v. Bharti Overseas Pvt. Ltd. [2016] 237 Taxmann 417 (Del)*** where it was held that if there is no interest expenditure "which is not directly attributable to any particular income or receipt", then "the question of applying the formula" under Rule 8D (ii) of the Rules will not arise.

21. Mr. Vohra referred to the statement given in the accounts, balance sheets etc. for the years ended 31st March 2007 as well as 31st March

2008 and submitted that in the present case it has been accepted by the ITAT, on facts, that the loans had been utilized only for the purpose of business and not for making investment and therefore, no proportionate disallowance was required to be made. Mr. Vohra placed reliance on the decision of the Supreme Court in ***Godrej & Boyce Manufacturing Co. Ltd. v. DCIT [2017] 394 ITR 449 (SC)*** which held that in case no disallowance was made in earlier years on the ground that no borrowed funds had been utilized for the purpose of earning tax free income, no disallowance can be made in later year also, following the principle of consistency. It was further held that, irrespective of the fact that Rule 8D is retrospective or not, disallowance was to be determined either on best judgment determination, as earlier prevailing, or as per Rule 8D. In the absence of new facts or changed circumstances, it was argued, there was no justification for the ITAT not following its own order for the earlier AYs in the Assessee's own case. Mr. Vohra also placed reliance on the decision of the Punjab and Haryana High Court in ***CIT, Jalandhar-I v. Max India Limited [2016] 388 ITR 81 (P&H)***.

22. As regards disallowance on account of administrative expenses forming subject matter of ITA No. 549 of 2015 in these appeals, Mr. Vohra submitted that the AO had not considered the written note submissions and details provided by the Assessee regarding investment and nature thereof in the assessment order. Mr. Vohra further submitted that in, both, ***Maxopp Investment Limited v. CIT [2012] 347 ITR 272 (Del)*** as well as the decision of the Bombay High Court in ***Godrej &***

Boyce Manufacturing Co. Ltd v. CIT [2010] 328 ITR 81 (Bom), it was emphasized that "while rejecting the claim of the Assessee with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the AO would have to indicate cogent reasons for the same." It was also emphasized that the satisfaction of the AO "must be arrived at on objective basis."

23. Mr. Vohra submitted that the calculation for the amount of Rs. 3 lakhs claimed as the administrative expenses had been submitted by the Assessee, along with the letter dated 15th November 2010 to the AO. This was relatable to the cost of the finance department at the corporate office. Even in the earlier AYs 2005-06 to 2007-08, it had been held by the ITAT that disallowance for administrative expenses is to be determined with reference to the cost of the finance department. It is pointed out that the CIT (A) had upheld the disallowance by taking a view that Rule 8D was to be applied in AY 2008-09 without determining whether satisfaction had been properly recorded by the AO or not. In the absence of recording such satisfaction of basis, disallowance had to be restricted to what had been provided by the Assessee, i.e. Rs. 3 lakhs. Alternatively, it was submitted that for the purposes of Rule 8 D (iii) 0.5% of the average value of investment, in terms of the decision in ***ACB India Ltd. v. ACIT (2015) 374 ITR 108 (Del)*** worked out to Rs. 18.24 lakhs and not the exorbitant sum of Rs.2,08,21,695 as directed by the AO.

Submissions on behalf of the Revenue

24. Mr. Raghvendra Singh and Mr. Ashok Manchanda, learned Senior Standing counsel appearing for the Revenue, submitted as under:

(i) Section 14 A (2) of the Act read with Rule 8D (1) has two limbs. First, is the exercise of discretion which requires the AO to record satisfaction regarding correctness of the claim of expenditure made by the Assessee. This will have to be determined "having regard to the accounts of the Assessee of a previous year." Under the second limb, it is argued that, once such satisfaction has been validly recorded, the AO has no option but to apply the formula in accordance with sub-Rules (2) and (3) of Rule 8D. Reliance was placed on the decisions of this Court in ***CIT v. Taikisha Engineering India Limited*** *(supra)*, ***ACB India Limited v. ACIT*** *(supra)* and ***PCIT v. Bharti Overseas Pvt. Ltd.*** *(supra)*.

(ii) The question of recording of proper satisfaction by the AO was a mixed question of law and fact and on this aspect there were concurrent findings of both the lower appellate bodies in favour of the Revenue. In the absence of any perversity pleaded, the Assessee should not be allowed, in the appeal under Section 260A of the Act, to seek interference with the above concurrent findings. Further, no substantial question of law had been framed on this aspect.

(iii) The Assessee had itself offered a disallowance of Rs. 3 lakhs but had not explained the basis. The Assessee had simply adopted a

"historical figure". The validity of Rule 8D (2) had been upheld by the Bombay High Court in ***Godrej & Boyce Mfg. Co. Limited v. CIT*** *(supra)* which had been followed by this Court in ***Maxopp Investment Ltd v. CIT*** *(supra)*. It is pointed out that the decision in ***Godrej & Boyce Mfg. Co. Ltd. v. CIT*** *(supra)* on this aspect has in fact been upheld by the Supreme Court.

(iv) The history of Section 14A and Rule 8D showed that they were applied to apportion expenditure for earning exempt and non-exempt incomes when the Assessee carried a composite and indivisible business. Therefore, Rule 8D, being a general rule, could not be expected to produce an accurate amount in every case. Some variance was inevitable. In any event, hardship and inequity are no grounds for interference by this Court in matters of taxation.

(v) It is submitted that the three sub-clauses of Rule 8D(2) fulfil the "proximate cause" test and "nexus" test. Each of the three sub-clauses was directly or indirectly in relation to income which did not form part of the total income under the Act. It is, accordingly, submitted that no interference is called for with the judgment of the ITAT.

Analysis of relevant provisions

25. It is necessary in the first place to re-visit the statutory provisions that are involved, viz., Section 14 A of the Act and Rule 8 D of the Rules.

"14A. (1) For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act.

(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 sub-section (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."

26. The 'Memorandum Explaining the Provisions of the Finance Bill, 2001' [2001] 248 ITR (St.) 162, 195, by which Section 14 A was introduced, with retrospective effect from 1st April 1962, stated:

"Certain incomes are not includible while computing the total income as these are exempt under various provisions of the Act. There have been cases where deductions have been claimed in respect of such exempt income. This in effect means that the tax incentive given by way of exemptions to certain categories of income is being used to reduce also the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income.

> This is against the basic principles of taxation whereby only the net income, i.e., gross income minus the expenditure, is taxed. On the same analogy, the exemption is also in respect of the net income.
>
> Expenses incurred can be allowed only to the extent they are relatable to the earning of taxable income.
>
> It is proposed to insert a new section 14A so as to clarify the intention of the Legislature since the inception of the Income-tax Act 1961, that no deduction shall be made in respect of any expenditure incurred by the assessee in relation to income which does not form part of the total income under the Income-tax Act.
>
> The proposed amendment will take effect retrospectively from April 1, 1962, and will accordingly, apply in relation to the assessment year 1962-63 and subsequent assessment years."

27. In cases involving Section 14 A of the Act, the constant tug-of-war lies in the Revenue wanting to increase the expenditure incurred to earn exempt income for the purpose of disallowance, while the Assessee seeks to establish the opposite. In ***CIT v. Walfort Share and Stock Brokers P. Ltd. [2010] 326 ITR 1 (SC)***, the Supreme Court noted that legislative intent behind Section 14A was not to allow deduction in respect of any expenditure incurred by an Assessee in relation to exempt income, i.e. income which does not form part of the total income under the said Act, against the taxable income. The Supreme Court observed as under:

> "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 of the tax incentive by way of an exemption of exempt income without making any apportionment of expenses incurred in relation to exempt 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 in the 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."

28. In the same decision, the Supreme Court explained that " The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14A."

29. How this apportionment should take place was prescribed under Rule 8D which came to be introduced with effect from 24th March 2008. Rule 8 D reads thus:

"8D (1) Where the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with

(a) the correctness of the claim of expenditure made by the assessee; or

(b) the claim made by the assessee that no expenditure has been incurred,

in relation to income which does not form part of the total income under the Act for such previous year, he shall determine the amount

of expenditure in relation to such income in accordance with the pro visions of sub-rule (2).

(2) The expenditure in relation to income which does not form part of the total income shall be the aggregate of following amounts, namely:-

(i) the amount of expenditure directly relating to income which does not form part of total income ;

(ii) in a case where the assessee has incurred expenditure by way of interest during the previous year which is not directly attributable to any particular income or receipt, an amount computed in accordance with the following formula, namely: A x B/C

Where A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year;

B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year;

C = the average of total assets as appearing in the balance-sheet of the assessee, on the first day and the last day of the previous year;

(iii) an amount equal to one-half per cent of the average of the value of investment, income from which does not or shall not form part of the total income, as appearing in the balance-sheet of the assessee, on the first day and the last day of the previous year.

(3) For the purposes of this rule, the 'total assets' shall mean, total assets as appearing in the balance-sheet excluding the increase on account of revaluation of assets but including the decrease on account of revaluation of assets."

30. Rule 8 D (1) states more or less what Section 14 A (2) of the Act states. It requires the AO to first examine the accounts of the Assessee and then record that he is not satisfied with (a) the correctness of the Assessee's claim of expenditure or (b) the claim made by the assessee that no expenditure has been incurred. Unless this stage is crossed i.e. the stage of the AO recording that he is not satisfied with the clam of the Assessee in the manner indicated i.e. after examining the Assessee's accounts, the question of applying the formula under Rule 8D (2) does not arise. That this is a mandatory pre-requisite for applying Rule 8D (2) is fairly well-settled.

31.1 Illustratively reference may be made to the decision of the Bombay High Court in ***Godrej & Boyce Manufacturing Co. Ltd v. CIT*** (*supra*) which was concurred with by this Court in ***Maxopp Investment Limited v. CIT*** (*supra*) and reiterated in ***Commissioner of Income Tax v. Taikisha Engineering India Limited*** *(supra).*

31.2 The Bombay High Court in ***Godrej and Boyce Mfg. Co. Ltd v. DCIT*** *(supra)* upheld the constitutional validity of sub-sections (2) and (3) of Section 14 A of the Act. It was held that Section 14A was applicable to the dividend income earned from mutual funds. The exercise that had to be undertaken by the AO for applying Section 14A was explained thus:

> "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."

31.3 The Bombay High Court further observed as under:

"Parliament has provided an adequate safeguard to the invocation of the power to determine the expenditure incurred in relation to the earning of non-taxable income by adoption of the prescribed method. The invocation of the power is made conditional on the objective satisfaction of the Assessing Officer in regard to the correctness of the claim of the Assessee, having regard to the accounts of the Assessee. When a statute postulates the

satisfaction of the Assessing Officer "Courts will not readily defer to the conclusiveness of an executive authority's opinion as to the existence of a matter of law or fact upon which the validity of the exercise of the power is predicated". (***M. A. Rasheed v. State of Kerala [1974] AIR 1974 SC 2249***). A decision by the Assessing Officer has to be arrived at in good faith on relevant considerations. The Assessing Officer must furnish to the Assessee a reasonable opportunity to show cause on the correctness of the claim made by him. In the event that the Assessing Officer is not satisfied with the correctness of the claim made by the Assessee, he must record reasons for his conclusion. These safeguards which are implicit in the requirements of fairness and fair procedure under Article 14 must be observed by the Assessing Officer when he arrives at his satisfaction under sub-section (2) of section 14A."

Failure of the AO to record satisfaction

32. The question regarding the failure of the AO to record his dissatisfaction with the correctness of the Assessee's claim regarding administrative expenses of Rs. 3 lakhs arises in ITA 349 of 2015. Mr Raghvendra Singh is not entirely right in his submission that there is no question framed about the failure by the AO to record his satisfaction. In ITA 349 of 2015, the question framed by this Court by the order dated 15th October 2015 is in fact in two parts: viz., (i) Whether the AO recorded a proper satisfaction in terms of Section 14A (2) and Rule 8 (D) of the Rules and (ii) in calculating the disallowance at 0.5% of average value of investments as per clause (iii) of Rule 8 D (2) of the Rules?

33. The contention of Mr. Singh is that if there was a valid recording of

satisfaction by the AO as required by Rule 8D (1), then there was no option available to the AO other than to apply Rule 8D (2) of the Rules. Therefore, even according to the Revenue, the applicability of Rule 8D (2) hinges on the recording of the AO in terms of Rule 8D (1) that he was not satisfied with the Assessee's claim regarding expenditure incurred to earn the exempt income.

34. The Assessee had explained that Rs. 3 lakhs was being disallowed voluntarily as an "expenditure which could be attributable for earning the said income." The Assessee explained that the disallowance had been determined on the basis of cost of finance department in the ratio of exempt income to total turnover. On that basis the disallowance in AY 2005-06 was upheld by CIT (A) at Rs. 1 lakh. The disallowance for this AY was worked out as Rs. 1,42,404/- and since the Assessee had already made a disallowance of Rs. 3 Lacs, no further disallowance was called for.

35. In order to disallow this expense the AO had to first record, on examining the accounts, that he was not satisfied with the correctness of the Assessee's claim of Rs. 3 lakhs being the administrative expenses. This was mandatorily necessitated by Section 14 A (2) of the Act read with Rule 8D (1) (a) of the Rules.

36. In para 3.2 of the assessment order, the AO records that, in answer to the query posed by the AO requiring it to produce calculation for disallowances, the Assessee "submitted that they have not incurred any

expenditure for earning the dividend income." Thereafter, in para 3.3, the AO records "I have considered the submissions of the Assessee and found not to be acceptable." Thereafter, the AO proceeded to deal with the said provisions of Section 14A and Rule 8D and observed, in para 3.3.1, that making of investment, maintaining or continuing investment and time of exit from investment are well informed and well coordinated management decisions that, in relation to earning of income, are embedded in indirect expenses. It is then stated in para 3.4 that, in view of the above, the provisions of sub-section (2) of Section 14A and Rule 8D of the Rules are in operation and therefore, will strictly be adhered to by the Assessee. In para 3.6 of the assessment order, after discussing Section 14A(1) read with Rule 8D and referring to the decision of the Bombay High Court in ***Godrej and Boyce Mfg. Co. Ltd v. DCIT*** *(supra)*, the AO simply stated that "in view of the facts and circumstances and legal position on the issue as discussed above, I am satisfied that the Assessee had incurred expenses to manage its investments which may yield exempt income, and Assessee grossly failed to calculate such expenses in a reasonable manner to ascertain to ascertain the true and correct picture of its income and expenses."

37. In the considered view of this Court, the above observations of the AO in the assessment order are of a broad general nature not with particular reference to the facts of the case on hand.

38. The Court is also unable to agree with Mr. Singh that on this aspect there are concurrent findings of both the CIT (A) as well as the ITAT.

The CIT (A) disallowed the exempt expenses by merely repeating what the AO had stated about the cost that is built into so called 'passive' investments and simply recorded that the AO was bound to Rule 8D and, therefore, was justified in determining administrative costs at 0.5%. Here again, the CIT (A) failed to note that without the mandatory requirement, under Section 14A of the Act and Rule 8D of the Rules, of satisfaction being recorded being met, the question of applying Rule 8D (1) did not arise.

39. Turning now to the order of the ITAT, in para 33, it recorded the submission of the AR that the AO did not record any satisfaction about the Assessee not properly offering expenditure incurred in relation to the exempt income at Rs. 3 lakhs. The ITAT reproduced the contents of para 3.3.1 of the assessment order, which has been extracted by this Court hereinbefore, which contains general observations regarding earning of exempt income. This cannot be accepted as a recording by the AO of satisfaction regarding the claim of the Assessee after examining its accounts. Again, in para 34 of its order, the ITAT simply reproduced para 3.3.6 of the assessment order where, again, no reasons have been provided but only a conclusion has been reached that the AO was "satisfied that the Assessee had incurred expenses to manage its investments which may yield exempt income, and Assessee grossly failed to calculate such expenses in a reasonable manner to ascertain the true and correct picture of its income and expenses."

40. Consequently on the aspect of administrative expenses being disallowed, since there was a failure by the AO to comply with the mandatory requirement of Section 14 A (2) of the Act read with Rule 8D (1) (a) of the Rules and record his satisfaction as required thereunder, the question of applying Rule 8D (2) (iii) of the Rules did not arise. The question framed in ITA 549 of 2015 is answered accordingly.

Disallowance of interest expenses

41. As far as disallowance of interest expenses were concerned, the said question arises and has been framed in ITA 548 of 2015. The stand of the Assessee was that no interest bearing fund was utilised during the AY in question for making investments which yielded exempt income. Therefore, no disallowance on that score was warranted.

42. In this the context a reference is required to be made to the detailed response given by the Assessee in its letter dated 15th November 2010 in which it specifically stated that investments from where dividend units were received as income "was not made out of borrowed fund taken by the company." A reference was made to Schedule 3 of 'Secured Loans' of the audited financials which showed that the Assessee had not taken any new term loans. The balances of term loans as of 31st March 2008 were same as that at 31st March 2007. The term loan from Punjab National Bank was taken in the year 2004-05 and was utilized in repayment of term loan taken from Central Bank of India in the year 2004-05. The term loan from State Bank of India was taken in

2005-06, was utilized in repayment of existing term loans taken from Corporation Bank, State Bank of Patiala and Jammu & Kashmir Bank respectively in the year 2005-06 itself. It was stated that "term loans are not granted by the banks for making investments in mutual funds and same also cannot be utilities as per the terms of the loans for making investments in mutual funds." Further, an overdraft of Rs. 4,875.63 lakhs taken from the Deutsche Bank was showed under 'secured loans'. From the details filed in Annexure 'B' to the letter in question it was made evident that no investments in these mutual funds were made from Deutsche Bank. As of 31st March 2008, the Assessee had cheques in hand of Rs. 6,475.12 lakhs and this was sufficient to clear the overdraft facility. These cheques were credited on the next working day after close of the year and were utilized to clear the entire overdraft balance.

43. The Assessee further explained that the investments were made out of company bank accounts with overdraft facilities, viz., Central Bank of India, Citibank and ABN AMRO respectively. Some investments were also made out of switching over of funds from one scheme to another. A copy of the bank statements showed that "the company had utilized its own funds in form of collection from business operation, proceeds from realization of fixed deposits and re-investment from realization from other mutual funds schemes." These were evidenced by the positive balances as on the date of investment in these bank statements.

44. It was stated by the Assessee that there was profit from operations of Rs. 20,123.12 lakhs after providing for depreciation of Rs. 26,363.04 lakhs and the net cash funds of the Assessee stood at Rs. 14,427.69 lakhs. Therefore, after making all disbursements, including the investments made during the year, funds to the tune of Rs. 6966.96 lakhs were available at year end under the heads ‘cash’ and ‘bank deposits’. Therefore, the Assessee had substantial funds of its own to make investments under reference.

45. What is plain from the explanation offered by the Assessee, which was not discarded by the AO on facts, was that there was no part of the interest expenditure which did not bear a direct nexus to a loan that was already borrowed in some earlier year. As explained by this Court in ***Principal Commissioner of Income Tax v. Bharti Overseas Pvt. Ltd.*** (*supra*), if there is no interest expenditure "which is not directly attributable to any particular income or receipt", then "the question of applying the formula" under Rule 8D (ii) of the Rules will not arise. In other words, one of the pre-requisites for the applicability of the formula Rule 8 D (2) (ii) of the Rules for determining the extent of disallowance of interest, is that there must some interest expense which is not attributable to any particular income or receipt. In the present case, the AO does not indicate which part of the interest expense falls in the above category.

The decision in **Taikisha Engineering**

46.1 At this stage it is necessary to examine the decision of this Court in ***Commissioner of Income Tax v. Taikisha Engineering India Limited*** *(supra)*. It must be recalled that the ITAT has in the impugned order remanded the matter to the AO on the basis of the said decision.

46.2 In the first place, it requires to be noticed that said decision was in the context of two AYs 2008-09 and 2009-10, and, therefore, the question of applying Rule 8D of the Rules, which was inserted with effect from 24th March 2008, arose for consideration.

46.3 The facts of the case were that, for AY 2008-09, the Assessee had voluntarily disallowed expenditure of Rs. 1,15,000/- under Section 14A of the Act, the calculation for which was submitted before the AO. The AO noted that the voluntary disallowance offered in the return did not fulfil the requirements of Section 14A of the Act read with Rule 8D of the Rules. However, "no other reason was indicated." After discussing the decision of the Bombay High Court in ***Godrej & Boyce Mfg. Co. Limited v. CIT*** *(supra)*, the AO recomputed the disallowance by applying Rule 8D of the Rules and quantified the disallowance at Rs. 42,59,540/-. The difference was accordingly added and the returned income enhanced.

46.4 A similar exercise was undertaken by the AO for AY 2009-10. Again, Rs.2,76,194/- was disallowed by the Assessee, the AO computed the disallowance at Rs. 5,36,393/- and the disallowance was

deleted by the CIT (A) and affirmed by the ITAT. What weighed with the ITAT and the CIT (A) was that the Assessee had sufficient funds as well as non-interest funds which were in excess of total investment made and, therefore, the question of disallowing any interest expenditure did not arise.

46.5 The Court, after referring to the decision of this Court in ***Maxopp Investment Limited v. CIT*** *(supra)* and of the Bombay High Court in ***Godrej and Boyce Mfg. Co. Ltd v. DCIT*** *(supra),* emphasized that there was to be a minimum compliance with the mandatory requirement under Section 14A(2) read with Section Rule 8D which requires the AO to examine the accounts of the Assessee and, upon arriving at a dissatisfaction as to the correctness of the claim of the Assessee in respect of expenditure incurred in relation to exempt income, the AO can determine the amount of expenditure which should be disallowed in accordance with the method prescribed under Rule 8D of the Rules. The Court explained that, unless such dissatisfaction was recorded in the manner indicated under Section 14A of the Act, the question of invoking Rule 8D of the Rules and the formula there under does not arise.

46.6 On facts, this Court held that two factors were crucial in deciding the issue in favour of the Assessee. One was the failure of the AO to record his satisfaction and the second was the factual finding of the CIT (A) as well as the ITAT that "the Assessee had sufficient funds for making investments in shares and mutual funds."

46.7 The Court explained that for the purposes of Rule 8D (2) (ii), the AO was required to examine whether "the assessee has incurred expenditure by way of interest in the previous year and secondly whether the interest paid was directly attributable to particular income or receipt. In case the interest paid was directly attributable to any particular income or receipt, then the interest on loan amount to this extent or in entirety as the case may be, has to be excluded for making computation as per the formula prescribed."

47. The above decision does not hold anything contrary to what has been contended by the Assessee in the present case. If indeed the AO had undertaken the exercise as mandated by this Court in ***Commissioner of Income Tax v. Taikisha Engineering India Limited*** *(supra)*, he would have come to the conclusion that the interest paid during the AY by the Assessee was entirely towards loans borrowed in earlier years which had not been utilised for making investments that yielded exempt income. However, what is surprising is that the ITAT, by relying on the above observations, thought it fit to remand the matter to the AO for a fresh determination on the ground that the disallowance on account of interest under Rule 8D "cannot be deleted simply on the ground that the assessee's capital and interest free funds are more than the funds invested in securities yielding exempt income."

48. In fact, as rightly pointed out by the Assessee, this was not the ground on which the disallowance was deleted by the CIT (A) in the present case. As already noted the CIT (A) ordered the deletion on the

basis of a factual holding that no interest bearing funds were utilized by the Assessee during the AY in question for the investments that yielded exempt income. The Assessee went before the ITAT for rectification of the impugned order on account of the erroneous recording by the ITAT of its submission in this regard.

49. There was no necessity for the ITAT to have remanded the issue regarding disallowance of interest expenses under Section 14 A to the AO for a fresh determination. The details placed on record by the Assessee, and particularly its audited accounts, demonstrated with sufficient clarity that no part of any interest bearing funds had been utilised during the AY in question for making investments that yielded exempt income.

***Decision of the Supreme Court in* Godrej & Boyce**

50.1 At this juncture reference may be made to the decision of the Supreme Court in ***Godrej & Boyce Manufacturing Co. Ltd. v. DCIT [2017] 394 ITR 449 (SC)***. The Supreme Court affirmed the decision of the Bombay High Court in ***Godrej & Boyce Manufacturing Co. Ltd. v. DCIT*** (*supra*) on one question, viz., that Section 14 A of the Act included within its scope dividend income on shares in respect of which tax is payable under Section 115-O of the Act and income on units and mutual funds on which tax is payable under Section 115 R of the Act. However, the Supreme Court reversed the Bombay High Court on the second question viz., the applicability of Section 14 A to the appellant in that case.

50.2 In the process of discussing the second question, the Supreme Court observed that, irrespective of whether sub-sections (2) and (3) of Section 14A of the Act were retrospective, "what cannot be denied is that the requirement for attracting the provisions of Section 14A (1) of the Act is proof of the fact that the expenditure sought to be disallowed/deducted had actually been incurred in earning the dividend income." On facts, it was noted that, in all of the AYs 1998-99, 1999-2000 and 2001-02, "the Revenue had failed to establish any nexus between the expenditure disallowed and the earning of the dividend income in question."

50.3 The Supreme Court found no mention of the reasons which had prevailed upon the AO to hold that the claims of the Assessee, that no expenditure was incurred to earn dividend income, cannot be accepted and why the order of the ITAT for the earlier AYs were not acceptable to the AO, particularly, in the absence of any new fact or change of circumstances. Further, the Supreme Court held that no basis has been disclosed establishing a reasonable nexus between the expenditure disallowed and the dividend income received.

50.4 The Supreme Court was concerned with AY 2002-03, i.e. prior to Rule 8D being inserted in the statute book. Nevertheless it took note of the changes and observed that this would make no difference to the requirement of the AO having to establish "a reasonable nexus between the expenditure disallowed and the dividend income received." What also weighed with the Supreme Court was that the fact "that any part of

the borrowings of the Assessee had been diverted to earn tax free income despite availability of surplus or interest free funds available.....remains unproved by any material whatsoever."

51. In the present case, the Assessee has been able to demonstrate that the AO has failed to establish any direct nexus between the investments made by the Assessee and the interest expenditure incurred. On the other hand , the Assessee was able to show that any interest expenditure incurred was in respect of various bank loans during the course of the AY in question. The AO also failed to deal with the assertion of the Assessee that it had sufficient own funds and, as such, had no occasion to use borrowed interest bearing funds for that purpose.

Conclusion

52. As a result of the above discussion:

(i) The question as framed in ITA No. 548 of 2015 is answered in the affirmative by holding that the ITAT erred in remanding the matter concerning deletion of disallowance of any interest under clause (ii) of Rule 8D (2) of the Act to the AO for fresh determination in light of the decision in ***Commissioner of Income Tax v. Taikisha Engineering India Limited*** *(supra)*

(ii) The question framed in ITA No. 549 of 2015 is answered in the negative by holding that the AO failed to record proper satisfaction in terms of Section 14A (2) of the Act read with Rule 8D (1) (a) of the Rules and therefore, erred in calculating

the disallowance at 0.5% on overall value of the investments as per the Rule 8D (2) (iii) of the Rules.

53. The appeals are accordingly allowed. The effect is that the Assessee's appeal before the ITAT on the issue of Section 14 A read with Rule 8D of the Rules must be treated as allowed and the Revenue's appeal on the said issue must be treated as dismissed.

54. There shall be no order as to costs.

S. MURALIDHAR, J.

PRATHIBA M. SINGH, J.

AUGUST 23, 2017
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