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

+ **ITA No. 1453/2018**

Date of decision: 18th December, 2018

+ ITA No.1453/2018

THE PR. COMMISSIONER OF INCOME TAX -3..... Appellant
Through: Mr.Puneet Rai, Standing Counsel
versus

DLF HOME DEVELOPERS LTD Respondent

Through: Ms.Kavita Jha and Ms.Devika Jain
Advs.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE ANUP JAIRAM BHAMBHANI

SANJIV KHANNA, J. (ORAL)

On 14th December 2018, we had dictated the following order:-

“This appeal by Revenue under Section 260A of the Income Tax Act, 1961 ('Act', for short) in the case of M/s DLF Home Developers Ltd ('respondent-assessee', for short) pertains to assessment year 2011-12 and arises from the order of the Income Tax Appellate Tribunal dated 19.06.2018.

2. First issue which relates to addition of Rs. 3.46 crores on account of golf club membership fee, is accepted by the Counsel for the appellant-Revenue, that is covered against them vide decision dated 30.3.2012 passed in ITA No.180/2012 in the case of *DLF Commercial Developers Ltd*. An SLP against the said decision was also dismissed. (Pursuant to the order of merger, the golf club has merged with DLF Home Developers Ltd.)

3. Accordingly, no substantial question of law arises from disallowance of Rs.3.46 crores made by Assessing Officer ('AO', for short) on account of golf club membership fee.



4. The second issue relates to disallowance of more than Rs. 80.66 crores made by the AO under Section 14A of the Act, by applying Rule 8D of the Income Tax Rules, 1962 (Rules, for short).

5. The AO on the aforesaid question had observed:

“7. On perusal of the comparative Balance Sheets as on 31.03.2010 & 31.03.2011, it is noticed that the assessee company has shown to have invested its funds in equity shares, which stand at Rs.2,73,331.69/- lacs as at the beginning of the year and at Rs.1,78,239.36/- lacs as at the end of the year. However, the assessee has not attributed any expenses which have been incurred to carry out the activity of investments, though it is an accepted fact that for carrying out any such activity, some kind of expenditure necessary has to be incurred. In view of the income tax circular no.5/2014 assessee vide order sheet entry dated 24.03.2014 was asked that since the assessee has done investment and has earned dividend income during current FY why expenses shall not be disallowed u/s 14A r.w. Rule 8D. In response to the same the assessee vide its reply dated 24.03.2014 submitted that “the assessee company on its accord, has made a disallowance of Rs.8,21,883/- as attributable to exempt income u/s 14A r.w. Rule 8D of the IT Rules, 1962. Therefore, on the facts and circumstances of the case, no further disallowance is called for.

7.1 The submissions of the assessee are considered but the same are not acceptable in view of the following background;

- *The provision of sub-section (1) of Section 14A provides:*

“14.4 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.”

- *The term “expenditure” occurring in Section 14A would take in its sweep not only direct expenditure but also all forms of expenditure **regardless of whether they are fixed, variable, direct, indirect, administrative, managerial or financial.***
- *As regards the applicability of Rule 8D of the I.T. Rules, the Hon’ble ITAT in the case of **Citicorp Finance (I) Ltd.** Held that “...it is no longer open to the Assessing Officer to apply his discretion in computing the disallowance or make adhoc disallowance u/s 14A...” as “...sub-sections (2) and (3) seek to achieve the underlying objection of section 14A(1) that any expenditure incurred in relation to exempt income should not be allowed deduction...”.*
- *The Hon’ble Bombay High Court, in its judgment delivered on 12.08.2010 in ITXA No.626/2010 & Writ Petition No.758/2010 in the case of **Godrej & Boyce Manufacturing Co. Limited, Mumbai vs. Dy.CIT-10(2), Mumbai & others;** has ruled in favour of the Department as regards the applicability of Rule 8D for and from A.Y. 2008-09 onwards.*
- *In view of the above, the disallowance u/s 14A r.w. rule 8D as computed as under:-*

<i>Clause</i>	<i>Particulars</i>			<i>Amount (In Lakhs)</i>
<i>i.</i>	<i>Expenditure directly related to exempt income</i>			<i>NIL</i>
<i>ii.</i>	<i>Disallowance of interest expenditure</i>			
	<i>A. Interest expenditure incurred during the year</i>	<i>36,150.41</i>		



	<i>B. Average Value of Investment</i>	2,73,331.69 +	2,25,785.53	
		1,78,239.36		
	<i>C. Average of total assets</i>	12,48,368 + 11,01,824/2		
		36,150.41* 2,25,785.53/ 11,75,096	11,75,096	
	<i>Disallowance = A*B/C</i>		6,946.01	6,946.01
iii.	<i>Aggregate of Opening and Closing value of Investment (Average Value of Investment) V*% of above as per Rule 8D</i>	<i>Value of investment Total for 30.03.2011 & 31.03.2010 Average value of Investment 0.5% of above</i>	<i>as on 31.03.2011 2,73,331.69 4,51,571.05 2,25,785.53 1,128.93</i>	<i>as on 31.03.2010 1,78,239.36 1,128.93</i>
	<i>Total disallowance [Aggregate of (i), (ii) & (iii)]</i>			8,074.94

7.2 The disallowance as worked u/s 14A r.w. Rule 8D comes to **Rs.80,74,94,000/-** however, the assessee has already disallowed Rs. 8,21,883/- as expenditure u/s 14A r.w. Rule 8D. Therefore, an amount of **Rs.80,66,72,117/-** (Rs.80,74,94,000 – Rs.8,21,8830/- is being disallowed and added back to the total income of the assessee u/s 14A read with Rule 8D of I. T. Rules, 1962.

(Addition of Rs.80,66,72,112/-)”

6. The Commissioner of Income Tax (Appeals), ('CIT (Appeals)', for short) partly allowed the appeal filed by the assessee, holding :-

“7.1 Having gone through the detailed submissions of the appellant, the order of assessment passed by the



Assessing Officer and the material facts placed on the record, it emerges from the facts of the case that the Assessing Officer has made an addition of Rs.80,66,72,112/- u/s 14A of the Income-tax Act, 1961 read with Rule 8D (2)(ii) and (iii) of the Income Tax Rules, 1962 on account of expenditure relating to earning the exempt income. In this regard, it has been submitted that the appellant has enough interest free funds in the form of paid up share Capital & Reserves and Surplus of Rs.2,95,937/- lacs. The appellant has made investments of Rs.2,73,326/- lacs in the shares of various companies, units of the mutual funds & in partnership firms out of these funds. The appellant has claimed that as the appellant is having sufficient interest free funds which are far more than that of the investments made, therefore, the investments were not made out of interest bearing funds and it has not incurred any interest cost for making such investment. The AR argued during the course of appellant proceedings that the disallowance has been made mechanically without looking into facts of the case. The investment was made in the group companies which proves that the investments were not made for earning any exempt income, rather the investment was made for the bonafide business purpose in the companies/concerns engaged in real estate business. The balance sheet shows that the appellant is having interest free funds in the form of paid up share capital of Rs.92,66,765/- lacs and Reserves and Surplus of Rs.2,03,26,935/- lacs aggregating to Rs.2,95,26,935/- lacs. The appellant has made the investment of Rs.2,73,326.57 lacs in shares and securities and mutual funds. The above figures show that the interest free funds of Rs.2,95,26,935/- lacs were sufficient for making the investment of Rs.2,73,32,657/- lacs. It is also seen from the investment schedule of the appellant that the companies/concerns in which the investments were made were mainly engaged in real



estate activities. From the discussion made above, it is clear that the contention of the appellant is right that it has not utilized any interest bearing funds for making the investments in subsidiary companies, partnership firms and mutual funds in view of the enough interest free funds available with the appellant. The appellant further submitted that the funds borrowed on interest were utilised for the real estates projects of the appellant. There is no nexus between the funds borrowed and investments made by the appellant in shares and bonds. Therefore, it cannot be presumed that interest cost has been incurred for earning the exempt income. This also justify that appellant has no intention for making the investments to earn any tax free income, rather it was made for the bonafide business purpose of appellant company. The provisions of section 14A read with rule 8D cannot be applied mechanically for making the disallowance. The Assessing Officer has to apply his mind to determine whether disallowance worked out on the basis of Rule 8D is justified in accordance with facts & circumstances of each case and a particular expenditure has been actually incurred for earning the exempt income or not. There has to be a proximate cause for the disallowance of interest with that of earning of the exempt income. However, in this case the Assessing Officer has not given any finding that the interest bearing funds were utilised for earning the exempt income.

The appellant has relied on the following judicial precedents:

CIT Vs. Hero Cycles 323 ITR 158 (PH)

Walfort Shares & Brokers Pvt. Ltd. 2010 326 ITR 1(SC)

Godrej Agrovet Ltd. Vs. ACIT (ITAT Mumbai)

Dy. CIT Vs. Maharashtra Seamless Ltd. (ITAT Delhi)

Dy. CIT Vs. Jindal Photo Ltd (ITAT Delhi)



In view of the above discussion, it is evident that interest cost cannot be attributed towards making the investment for earning the exempt income, therefore, no disallowance on account of interest of Rs.6946.01 lacs/- can be made u/s 14A read with Rule 8D(2)(ii) of the Rules..”

7. Thus, the CIT (Appeals) had clearly held that AO failed to apply his mind on whether disallowance made by the respondent-assessee under Section 14A of the Act read with Rule 8D was justified in the facts and circumstances of the case. He held that there was no nexus between the funds borrowed and investments made by the respondent-assessee in the form of shares, securities and mutual funds leading to the exempt income. Interest free funds of Rs. 2,95,26,935/- lacs in the form of paid-up share capital, Reserves and Surplus were sufficient for making investment of Rs.2,73,326.57/- lacs. Addition made by the AO under clause (ii) of Rule 8D(2) was deleted. After recording the aforesaid findings, the CIT (Appeals) went on to uphold addition of Rs. 1128.93 lacs under clause (iii) of Rule 8D(2) of the Rules holding that assessee must have incurred administrative costs for earning the exempt income. Respondent-assessee must have incurred expenditure for earning exempt income, which were debited to the profit and loss account. Accordingly, disallowance of Rs. 11.28 crores was upheld.

8. The Revenue and the respondent-assessee preferred cross-appeals before the Trial Court on the question of disallowance under Section 14A of the Act. The Tribunal on this aspect has accepted the appeal preferred by respondent-assessee and dismissed the appeal preferred by the Revenue relying upon the decisions of the Bombay High Court in **CIT-2, Mumbai vs. HDFC Bank Ltd. – (2014) 49 taxmann.com 335 (Bombay)** and decision of the Supreme Court in **Godrej & Boyce**



Manufacturing Company Ltd. vs. DCIT, (2017) 394 ITR 449 SC and decision of Delhi High Court in ***HT Media Ltd. vs. Principal Commissioner of Income Tax-IV (2017) 399 ITR 576.***

9. The second issue, in our opinion, is already covered by the decision of the Supreme Court in ***Maxopp Investment Ltd. vs. CIT (New Delhi) [2018] 402 ITR 640 (SC)*** in which, it is inter-alia held as under:-

“41. Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, we also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the assessee, suo moto disallowance under section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for purchasing the shares/making the investment in shares is to be examined by the AO.”

10. Appropriate in this regard are also the observations of the Supreme Court in ***Godrej & Boyce Manufacturing Company Ltd. (Supra)*** wherein they have held as under:-

“37. We do not see how in the aforesaid fact situation a different view could have been taken for the Assessment Year 2002-2003. Sub-sections (2) and (3) of Section 14A of the Act read with Rule 8D of the Rules merely prescribe a formula for determination of expenditure incurred in relation to income which does not form part of the total income under the Act in a situation where the Assessing Officer is not satisfied with the claim of the assessee. Whether such determination is to be made on application of the formula prescribed under rule 8D or in



the best judgment of the Assessing Officer, what the law postulates is the requirement of a satisfaction in the Assessing Officer that having regard to the accounts of the assessee, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the Assessee. It is only thereafter that the provisions of Section 14A(2) and (3) read with Rule 8D of the rules or a best judgment determination, as earlier prevailing, would become applicable.”

11. In the aforesaid ruling it has been held by the Supreme Court that Rule 8D is in the nature of best judgment determination. This Rule would apply where the AO first records his satisfaction that disallowance, if any, made by the Assessee is not correct and is not in accordance with the mandate of Section 14A of the Act. In absence of formation of satisfaction, the AO cannot apply Rule 8D of the Rules. In the present case, the AO has treated Rule 8D as mandatory which would apply to all cases where exempt income is earned. An order passed by AO is, therefore, not in terms of the mandate of Section 14A(2) of the Act.

12. Regarding the aforesaid position, we do not find that any substantial question of law arises from the second issue.

13. The appeal is dismissed without any costs.”

However, before signing the above order, we noticed observations made by the Commissioner of Income Tax (Appeals) in para 7.3, which read as under:-

“Accordingly, I am of the considered view that appellant has incurred various indirect expenses for earning the exempt income and such expenses have been debited in the profit and loss account. There may not be a direct head relating to



investment expenditure but all indirect expenses debited to profit and loss account indirectly relates to investment activities also. The Assessing Officer may not have given any finding in this regard but the powers of the CIT (Appeal) are co-terminus with that of the Assessing Officer, therefore, I am satisfied that the appellant has incurred various indirect expenses on administration which are indirectly related to investment activities and earning of the exempt income in view of this, the disallowance of Rs.1128.93 lacas (sic) made by the Assessing Officer under Rule 8D(2)(iii) read with Section 14A is sustained”.

The issue that arises for consideration is whether the Commissioner of Income Tax (Appeals) could have recorded a satisfaction in terms of sub-section (2) of Section 14A of the Income Tax Act. This issue has not been examined in any of the earlier decisions. Hence, we are inclined to issue notice, in view of the observations made by the Commissioner of Income tax (Appeals) in para 7.3 noted above.

Issue notice returnable on 19th March, 2019.

Notice is accepted by Ms.Kavita Jha, Advocate counsel for the respondent.

भारतमेव जयते

SANJIV KHANNA, J.

ANUP JAIRAM BHAMBHANI, J.

DECEMBER 18, 2018/neelam