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

+ **ITA 7/2020 & CM APPL.943/2020**

CARGO MOTORS PVT. LTD. Appellant

Through: Mr.Ved Jain, Advocate with
Mr.Nischay Kantoor, Advocate.

versus

DY COMMISSIONER OF INCOME TAX Respondent

Through: Mr.Abhishek Maratha, Sr.Standing
Counsel with Ms.Chazat Lawang,
DCIT-Circle 4(2).

% Date of Decision: 07th October, 2022

CORAM:

HON'BLE MR. JUSTICE MANMOHAN

HON'BLE MS. JUSTICE MANMEET PRITAM SINGH ARORA

J U D G M E N T

MANMOHAN, J (Oral):

1. Present Income Tax Appeal has been filed challenging the order dated 31st July, 2019 passed by the Income Tax Appellate Tribunal ('ITAT'), Bench "B", New Delhi in ITA No.5944/Del/2016, whereby appellant's appeal against the disallowance of Rs.6,05,176/- made under Section 14A of the Income Tax Act, 1961 ('the Act') was dismissed.

2. On 19th September, 2022, this Court had admitted the appeal and framed the following question of law for consideration:-

“Whether in the facts and circumstances of the case the Ld.ITAT has erred in confirming the disallowance made under Rule 8D by not restricting the disallowance to 0.5% of those investment only where the assessee had earned exempt income?”



RELEVANT FACTS

3. The relevant facts of the present case are that the assessee during the year had earned dividend income of Rs.12,92,735/- from three companies, namely, Tata Motors Ltd., Tata Consultancy Services Limited and Mundra Port. The details of the ledger account of the dividend income in the books of the assessee were filed before the Assessing Officer with letter dated 14th January, 2016. This dividend income formed part of the audited accounts under the head 'other income' – Schedule 19 of the balance sheet where dividend on non-current investment was shown at Rs.12,92,735/-. This schedule was part of the audited balance sheet and the dividend income of Rs.12,92,735/- was also duly shown in the computation of income filed with the return of income.

4. During the course of the assessment, the Assessing Officer raised the issue of disallowance under Section 14A.

5. In response thereto, the assessee filed a detailed reply dated 14th January, 2016 wherein it stated, *“The assessee has shown dividend income of Rs,12,92,735/- (detail enclosed at page no.774) which has been received on shares of Tata Motors Ltd., Tata Consultancy Services limited and Mundra Port.”* The details of these investments in these companies were also given in a separate table. Further, in this letter, the assessee stated, *“Dividend income of Rs.12,92,735/- was received through ECS and directly credited in the bank account. Only six dividend warrants were received during the year.”* In this letter, the assessee also contended that in absence of dividend income, no disallowance can be made under Section 14A as there was no exempt income from other investments and the same need to be excluded while computing disallowance under Section 14A. The relevant



portion of the letter reads as under:-

“Out of the total investment of Rs.24,22,14,939/-, the assessee has dividend income only from Tata Motors, Tata Consultancy and Mundra Port, where the total investment in these companies was Rs.2,59,11,939/- both at the beginning and close of the year. These investments were made out of own funds as held in all completed assessments. Further, there is no exempt income in the other investments of Rs.21,63,03,000/- which was mainly in subsidiary and other group companies, which were all private limited companies whose shares were not quoted.”

6. The Assessing Officer without disputing the above facts computed a disallowance by applying 0.5% of total average investments instead of average investments which had yielded dividend income as is evident from para 4.10 of the assessment order, which is reproduced hereinbelow:-

“4.10 Keeping in view of above discussion and guideline prescribed by CBDT in circular no.5/2014 provisions of disallowance u/s 14A r.w. Rule 8D is invoked. The language of Rule 8D(2) refers to investment income from which 'does not or shall not' form part of total income. Thus, the focus of the provision is on those investments which have the potential to give rise to exempt income - presence of actual exempt income in a particular year being irrelevant. The assessee has not added disallowance under section 14A in the computation of income. Therefore, provisions of disallowance u/s 14A r.w.r 8D is applicable in this case. Disallowance u/s 14A is computed as under:

<i>S.No.</i>	<i>Particulars</i>	<i>Amount in Rs.</i>
<i>i.</i>	<i>Expenses directly attributable</i>	<i>NIL</i>
<i>ii.</i>	<i>Interest Expenses A*B/C</i>	<i>NIL</i>
<i>iii.</i>	<i>0.5% of the average investments=0.5% of B</i>	<i>7,34,450/-</i>
	<i>Less: Amount already disallowed u/s 14A in return of income filed for AY 2013-14</i>	<i>1,29,274/-</i>



	<i>Disallowance Expenses</i>	6,05,176/-
A	<i>Total interest</i>	
	<i>Opening of investment</i>	5,15,64,939/-
	<i>Closing of investment</i>	24,22,14,939/-
B	<i>Average value of the investment</i>	14,68,89,939/-
	<i>Opening value of the asset</i>	3,55,66,43,5247/-
	<i>Closing value of the asset</i>	4,72,23,40,603/-
C	<i>Average value of the asset</i>	4,13,94,92,065
	<i>Disallowance u/s 14A of the IT Act 1961 (i+ii+iii)</i>	6,05,176

Accordingly, Rs.6,05,176/- is disallowed and added back to the income of the assessee.

(Addition of Rs.6,05,176/-)”

7. In appeal, the CIT(A) upheld the order of the Assessing Officer and took note of the above facts in para 4.2 of the order which reads as under:-

“4.2. Perusal of Assessment order dated 04.03.2016 as well as submission of the appellant during appellant proceedings reveal that in the given year, the appellant earned dividend income of Rs. 12,92,735/- on account of investment in shares and securities of Tata Motors Ltd, Tata Consultancy Ltd. & Mundra Port and is claiming the same as exempt. The appellant made disallowance u/s. 14A of Rs.1,29,274/- out of the exempt income being 10% of dividend income. To quote appellant's own words, "to avoid controversy and unnecessary litigation".....”

8. Upon the matter being carried forward in appeal, the Tribunal after recording the fact of receipt of dividend income was from three companies only, concurred with the orders of the Assessing Officer and CIT(A).

ARGUMENTS ON BEHALF OF THE PETITIONER

9. Learned counsel for the appellant states that the issue that the assessee has earned dividend income only from three companies, namely, Tata



Motors Ltd., Tata Consultancy Services Limited and Mundra Port is not in dispute and that the disallowance, if any, is to be considered in respect of such investments which have yielded exempt income during the year. He submits that the issue that disallowance at the rate of 0.5% is to be computed with reference to average investments which have yielded exempt income and not total investments is covered by the various judgments of this Court as well as other High Courts.

ARGUMENTS ON BEHALF OF THE RESPONDENT

10. *Per contra*, learned counsel for the respondent states that the assessee company in the relevant assessment year has earned dividend income exempt from tax of Rs.12,92,735/- on a total investment of Rs.24.22 crores in shares. He emphasises that the petitioner-assessee had made an investment of Rs.24.22 crores with the intent of earning exempt income and therefore the total investment should be taken into account. He submits that the earning of exempt income is not a passive activity and is a conscious decision of the assessee involving the engaging of informed experts and senior management. He states that the same is bound to lead to certain incidental administrative expenses embedded in indirect expenses.

11. He submits that the language of the Rule 8D(2) while providing for disallowance of such expense refers to such expenses incurred to earn income which “does not or shall not” form part of the total income. According to him, the said expression clothes the Assessing Officer with the power to make disallowance even in case where the assessee has not earned exempt income in a particular year as long as there exists potential to earn exempt income. Therefore, according to him, the assessee’s submission that Assessing Officer should have restricted the disallowance to 0.5 percentage



of only those investments where assessee has earned exempt income is a total misunderstanding of the principle behind Section 14A read with Rule 8D.

12. He also relies upon the CBDT Circular No.5/2014 dated 11th February, 2014 which according to him clarifies that Rule 8D read with Section 14A provides for disallowance even where no exempt income has been earned in a particular year.

COURT'S REASONING

ONLY THOSE INVESTMENTS ARE TO BE CONSIDERED FOR COMPUTING AVERAGE VALUE OF INVESTMENTS WHICH YIELDED EXEMPT INCOME DURING THE RELEVANT ASSESSMENT YEAR

13. Having heard learned counsel for the parties, this Court is of the view that while Section 14A is the charging Section, Rule 8D is a method/mechanism to determine the amount of expenditure incurred in relation to income, which does not form part of the total income of the assessee. By virtue of the charging Section, namely, Section 14A, the Assessing Officer has the power only to determine the amount of expenditure incurred in relation to such income which does not form part of the total income under the Act.

14. This Court is further of the view that Rule 8D(2)(iii) clearly postulates that in the calculation of the disallowance amount, "an amount equal to one-half percent of the value of the investment, income from which does not or shall not form part of the total income" should be taken into consideration. Thus, it is not all investment but only that which is expressly spelt out in Rule 8D(2)(iii) read with Section 14A and Rule 8D(i) which is to be



reckoned for the purpose of calculation of average of half percent.

15. In fact, the aforementioned issue is no longer *res integra*. A Division Bench of this Court in ***ACB India Limited (formerly M/s Aryan Coal Benefications (P) Ltd. Vs. Assistant Commissioner of Income Tax, ITA 615/2014*** has held as under:-

“4. The AO, instead of adopting the average value of investment of which income is not part of the total income i.e. the value of tax exempt investment, chose to factor in the total investment itself. Even though the CIT (Appeals) noticed the exact value of the investments which yielded taxable income, he did not correct the error but chose to apply his own equity....”

16. Another coordinate Bench of this Court in ***Pr.Commissioner of Income Tax-2 Vs. M/s Caraf Builders & Constructions Pvt. Ltd., 2018 (12) TMI 410*** has held as under:-

“26. There is another error made by the Assessing Officer in computing the disallowance under clauses (ii) of Rule 8D(2) with reference to the formula prescribed. Numerical B in clause (ii) refers to average value of the investment, income from which does not form part or shall not form part of the total income. The Assessing Officer for numerical B in clause (ii) had taken the total value of the investment and not the investment that had yielded exempt income. The Delhi High Court in ITA No. 615/2014, ACB India Ltd. vs. Asstt. Commissioner of Income Tax decided on 24th March, 2015 has held that only average value of the entire investment that does not form part of the total income is the factor which could be covered by the numerical B for computing disallowance under clause (ii) of Rule 8D(2) of the Rules....”



17. Even the Madras and Calcutta High Courts have taken similar views.
18. The Madras High Court in *The Commissioner of Income Tax, Chennai Vs. Shriram Ownership Trust, 2020 (12) TMI 736-Madras High Court* has held as under:-

“2.The following substantial questions of law have been framed for consideration of this Court:-

“1.Whether the Tribunal was correct in holding that the investment which yielded no exempt income was to be excluded while computing deduction u/s.14A when the Act as well as Rules framed do not provide for any such exception, and further such investment shall always remain in tax free territory?”

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39.The first substantial question of law raised by the revenue in this appeal is whether the Tribunal was right in holding that the investment which yielded no exempt income was to be excluded while computing deduction under Section 14A when the Act as well as the Rules do not provide for any such exception. An identical question was raised by the revenue in the assessee's own case in T.C.A.No.241 of 2018 for the assessment year 2013-14. When the said tax case appeal was heard, we noted that the substantial question of law has to be answered in favour of the assessee in the light of the decision of the Hon'ble Division Bench in the case of M/s.Marg Limited vs. CIT, Chennai [T.C.A.Nos.41 to 43 and 220 of 2017 dated 30.09.2020]. However, the appeal filed by the revenue was dismissed on 08.07.2020 owing to low tax effect. The revenue cannot dispute the fact that the above substantial question of law was decided in favour of the assessee. In the case of M/s.Marg Limited, in which the decision of the High Court of Karnataka in Pragathi Krishna Gramin Bank vs. JCIT [(2018) 95 Taxman.com 41(Kar.)] was followed. Further, the Delhi Bench of ITAT in the case of ACIT, Circle 17(1), New Delhi vs. Vireet Investment (P) Ltd. [(2017) 82 Taxman.com 415 (Delhi-Trib.) (SB)] also decided the said issue in favour of the assessee. Thus, following the above



referred decision, substantial question of law No.1 is answered in favour of the assessee and against the revenue.”

19. Another Division Bench of the Madras High Court in *Commissioner of Income-tax, Central 1, Chennai Vs. Chettinad Logistics (P) Ltd., (2017) 80 taxmann.com 221 (Madras)* has held as under:-

“9. In our opinion Section 14 A of the Act, can only be triggered, if, the Assessee seeks to square off expenditure against income which does not form part of the total income under the Act.

9.1 The legislature, in order to do away with the pernicious practice adopted by the Assessee's, to claim expenditure, against income exempt from tax, introduced the said provision.

10. In the instant case, there is no dispute that no income i.e., dividend, which did not form part of total income of the Assessee was earned in the relevant assessment year.

10.1 Therefore, to our minds, the addition made by the Assessing Officer by relying upon Section 14 A of the Act, was completely contrary to the provisions of the said Section.

10.2 Mr.Senthil Kumar, who appears for the Revenue, submitted that the Revenue could disallow the expenditure even in such a circumstance by taking recourse to Rule 8D.

10.3 According to us, Rule 8D, only provides for a method to determine the amount of expenditure incurred in relation to income, which does not form part of the total income of the Assessee.

10.4 Rule 8 D, in our view, cannot go beyond what is provided in Section 14A of the Act.”

20. Recently, Calcutta High Court in *Principal Commissioner of Income Tax, Central-1, Kolkata Versus M/s. Shalimar Pellet Feeds Ltd., 2022 (2) TMI 1209* has held as under:-

“.....The next substantial question of law is with regard to the disallowance under Section 14A of the Act. The tribunal after noting several decisions has directed the assessing officer to



compute the disallowance as per Rule 8D by taking into consideration only those shares which have yielded dividend income in the year under consideration. Though the Tribunal has noted the decision of the Tribunal in REI Agro Ltd. Vs. DCIT (2013) 35 taxmann.com 404, there are several other decisions on the said point and the machinery provision under Rule 8D can be applied only with regard to the shares which yielded dividend income in year under consideration. Therefore, we find that the tribunal rightly applied the legal principle and granted relief.....”

21. Consequently, only those investments are to be considered for computing average value of investments which yielded exempt income during the relevant assessment year.

RESPONDENT’S RELIANCE ON THE CBDT CIRCULAR NO.5/2014 IS UNTENABLE IN LAW AS THIS COURT IN PR.COMMISSIONER OF INCOME TAX-04 VS. IL & FS ENERGY DEVELOPMENT COMPANY LTD., 2017 (8) TMI 732 HAS HELD THAT THE SAID CIRCULAR CANNOT OVERRIDE THE EXPRESS PROVISIONS OF SECTION 14A READ WITH RULE 8D

22. The respondent’s reliance on the CBDT Circular No.5/2014 is also untenable in law, inasmuch as, another Division Bench of this Court in ***Pr.Commissioner of Income Tax-04 Vs. IL & FS Energy Development Company Ltd., 2017 (8) TMI 732*** has held as under:-

13. In the above background, the key question in the present case is whether the disallowance of the expenditure will be made even where the investment has not resulted in any exempt income during the AY in question but where potential exists for exempt income being earned in later AYs.

14. In the Explanatory Memorandum to the Finance Act 2001, by which Section 14A was inserted with effect from 1st April 1962, it was clarified that "expenses incurred can be allowed only to the



extent they are relatable to the earned income of taxable income". The object behind Section 14A was to provide 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".

15. What is taxable under Section 5 of the Act is the "total income" which is neither notional nor speculative. It has to be 'real income'. The subsequent amendment to Section 14A does not particularly clarify whether the disallowance of the expenditure would apply even where no exempt income is earned in the AY in question from investments made, not in that AY, but earlier AYs.

16. Rule 8D (1) of the Rules is helpful, to some extent, in understanding the above issue. It reads as under:

"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 provisions of sub-rule (2)."

17. The words "in relation to income which does not form part of the total income under the Act for such previous year" in the above Rule 8 D (1) indicates a correlation between the exempt income earned in the AY and the expenditure incurred to earn it. In other words, the expenditure as claimed by the Assessee has to be in relation to the income earned in 'such previous year'. This implies that if there is no exempt income earned in the AY in question, the question of disallowance of the expenditure incurred to earn exempt income in terms of Section 14A read with Rule 8D would not arise.

18. The CBDT Circular upon which extensive reliance is placed by Mr. Hossain does not refer to Rule 8D (1) of the Rules at all but only refers to the word "includible" occurring in the title to Rule 8D as well as the title to Section 14A. The Circular concludes that



it is not necessary that exempt income should necessarily be included in a particular year's income for the disallowance to be triggered.

19. In the considered view of the Court, this will be a truncated reading of Section 14 A and Rule 8D particularly when Rule 8D (1) uses the expression 'such previous year'. Further, it does not account for the concept of 'real income'. It does not note that under Section 5 of the Act, the question of taxation of 'notional income' does not arise. As explained in Commissioner of Income Tax v. Walfort Share and Stock Brokers Pvt. Ltd [2010] 326 ITR 1 (SC), the mandate of Section 14A of the Act is to curb the practice of claiming deduction of expenses incurred in relation to exempt income being taxable income and at the same time avail of the tax incentives by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. Consequently, the Court is not persuaded that in view of the Circular of the CBDT dated 11th May 2014, the decision of this Court in Cheminvest Ltd. (supra) requires reconsideration.

20. In M/s. Redington (India) Ltd. v. The Additional Commissioner of Income Tax, Company Range - V, Chennai (order dated 23rd December, 2016 of the High Court of Madras in TCA No. 520 of 2016), a similar contention of the Revenue was negated. The Court there declined to apply the CBDT Circular by explaining that Section 14A is "clearly relatable to the earning of the actual income and not notional income or anticipated income." It was further explained that,

"The computation of total income in terms of Rule 8D is by way of a determination involving direct as well as indirect attribution. Thus, accepting the submission of the Revenue would result in the imposition of an artificial method of computation on notional and assumed income. We believe thus would be carrying the artifice too far."

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24. For all of the aforementioned reasons, this Court is of the view that the CBDT Circular dated 11th May 2014 cannot override the express provisions of Section 14A read with Rule 8D."



23. Keeping in view the aforesaid mandate of law, the question of law is answered in favour of the appellant-assessee, as this Court is of the view that the ITAT has erred in confirming the disallowance made under Rule 8D by not restricting the disallowance to 0.5% of those investment only where the assessee had earned exempt income.

MANMOHAN, J

MANMEET PRITAM SINGH ARORA, J

OCTOBER 7, 2022
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