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

Date of Decision: 25th November, 2014

\+ ITA 115/2014 & 119/2014

COMMISSIONER OF INCOME TAX-VI

..... Appellant

Through Ms. Suruchi Aggarwal, Sr. Standing Counsel

versus

TAIKISHA ENGINEERING INDIA LTD

..... Respondent

Through Mr. K.R.Manjani, Advocate

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J. (Oral)

These two appeals by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act' for short) relate to assessment years 2008-09 and 2009-10.

2. The issue raised by the Revenue in these appeals pertains to Section 14A of the Act and Rule 8D of the Income Tax Rules, 1962 ('Rules' for short) and disallowance of expenditure relating to exempt income.

3. For the assessment year 2008-09, the respondent assessee had filed

return declaring total taxable income of Rs.31,14,68,297/- and exempt income of Rs.2,46,81,747/-. The assessee had voluntarily disallowed expenditure of Rs.1,15,000/- under Section 14A of the Act, calculation for which were submitted before the Assessing Officer by way of letter dated 2nd November, 2010. The Assessing Officer considered the reply and noted that the voluntary disallowance did not fulfil the requirements of Section 14A of the Act read with Rule 8D of the Rules. No other reason was indicated. Decision of the Bombay High Court in ***Godrej & Boyce Mfg. Co. Ltd. vs. CIT*** [2010] 328 ITR 81 (Bom.) and the principles enunciated and enumerated in the said decision were quoted. The Assessing Officer recomputed the disallowance by applying Rule 8D of the Rules and quantified the disallowance at Rs.42,59,540. As the assessee had himself disallowed an amount of Rs.1,15,000/-, the balance amount of Rs.41,44,540/- was added and the returned income enhanced.

4. For the assessment year 2009-10, the assessee had filed return declaring income of Rs.8,98,19,429/- and had voluntarily disallowed Rs.2,76,194/- under Section 14A of the Act. The Assessing Officer noticed that the assessee had earned exempt dividend income to the tune of Rs.17,43,782/- and had declared long term capital gain, which was not

taxable. The Assessing Officer recorded that he had considered the reply to justify the disallowance of Rs.2,76,194/-, but without any further elucidation held that the disallowance did not fulfil the requirements of Section 14A of the Act read with Rule 8D of the Rules. Disallowance by applying Rule 8D of the Rules was computed at Rs.5,36,393/-. As the assessee had disallowed Rs.2,76,194/- in the computation of income, the difference of Rs.2,60,199/- was added and the returned income enhanced.

5. Appeals were disposed of by the common order dated 26th March, 2012 by the Commissioner of Income Tax (Appeals) ('CIT(A)', for short), who deleted the addition after referring to the following part of the written submissions filed by the assessee in relation to the assessment year 2008-09:

> "Investment in Mutual Fund is made from current account in HDFC bank in which no interest is incurred. Investments were made out of surplus funds. Assessee deposited funds amounting to Rs. 28,7130,569.00 generated on sale of mutual fund during the F.Y. 2007-08 and funds amounting to Rs. 15,59,58,985.00 were used for acquiring the investment Which results into net surplus of Rs. 13,11,71,584.00. In support of this we have already filed the details of funds realised on sale of mutual funds and deposited along with the details funds utilized for investment in current of HDFC bank. Also copy of the bank statement showing these transactions is already filed. "Assessee having interest free funds far in excess of amount invested in mutual funds, no disallowance could be made under section 14A because the interest expenditure was incurred in respect of the borrowing in cash credit limits

> utilized for normal business purposes of the assessee and no part of the borrowed funds has been utilized by the assessee for making investment in the mutual funds. Rather on account of capital gain on sale of mutual funds, company generated surplus funds."

6. He observed that the assessee had share capital of Rs.60,00,000/- and Reserve & Surplus funds of Rs.53.19 crores as on 31st March, 2008 and share capital of Rs.60,00,000/- and Reserve and Surplus funds of Rs.41.49 crores as on 31st March, 2007. Therefore, no interest bearing funds had been used for making investments, which had yielded tax free income like dividends.

7. In respect of assessment year 2009-10, similar findings were recorded by the CIT(A), who observed that direct expenditure incurred by the respondent assessee was Rs.643.26 as DEMAT charges and in respect of interest income, he referred to the following explanation of the assessee:-

> "Interest Clause (ii)
> "Investment in Mutual Fund is made from current account in HDFC bank in which no interest is incurred. Investments were made out of surplus/own funds deposit earlier. Assessee deposited funds in HDFC current account amounting to Rs. 10,6715,425.00 generated on sale of mutual fund during the period October 07, March 2008 and Apr. 2008. Dividend amounting to Rs.57,90,120.00 received during the F.Y. 2007-08 also invested. Total surplus/own funds available are Rs. 112505545.00 utilised by assessee for making investment in the A.Y. 2009-10. Details are enclosed "Exhibit-3".

Photocopy of the bank statement for the Exhibit no. 3 for the period 01.10.2007 to 08.04.2008 is enclosed showing funds deposited marked vide "Exhibit-4".
Photocopy of the bank statement for the Exhibit no. 2 for the F.Y. 2008-09 is enclosed showing investment made marked vide "Exhibit-5".
As explained above no interest bearing funds were used by the assessee for investment. Interest bearing funds were used by the assessee for doing normal business of the company. Assessee used surplus/own funds for the investment in mutual funds.
As the assessee have interest free funds far in excess of amount invested in mutual funds. Therefore, no disallowance could be made under clause (ii) of section 14A because of the interest expenditure was incurred directly attributable to the business purpose. No part of the borrowed funds has been utilized by the assessee for making investment in mutual funds."
14.2 The AR relied on the following case laws:
• Sushma Kapoor 319 ITR 299 (Del.)
• DCIT vs. Maruti udyog Ltd. 92 ITJ 987 (Del.)
• Voltas Ltd. 125 ITJ 601 (Mum.) (Trb.)
• Dishman Pharmaceuticals Ltd. vs. DCIT 45 SOT 37 (Ahd) (URO)
15. I have gone through the assessment order and the detailed written submissions.
The AO worked out disallowance of Rs. 5,36,393/- under Rule 8D(2)(ii). The AR has explained that no borrowed funds were utilized for making the investment. The issue has been examined in the earlier years and found that no disallowance is called for under Rule 8D(2)(ii).
It is further seen that the disallowance under rule 8D(2)(iii) worked out to Rs. 2,76,194/- which was forgotten to be added by mistake. The AR has no objection for disallowing of Rs. 2,76,914/- which he has accepted in the assessment proceedings.
Relief: 5,36,393/-
Confirmed: 2,76,914/-

Accordingly Ground No.1 is partly allowed."

8. The Income Tax Appellate Tribunal ('Tribunal', for short) by a common order dated 27th September, 2013 has dismissed the appeals filed by the Revenue. Rule 8D of the Rules it was held was applicable and the issue related to computation under sub Rule (2) and the three sub-clauses. Reference was made to clause (ii) of sub Rule (2) to Rule 8D of the Rules and it has been held:-

> "2.4. ... Only clause (ii) is involved in the present appeal. The AO considered the total interest paid by the assessee for allocating a sum of [Rs.] 36.76 lakh to the investments yielding exempt income. At the threshold it needs to be determined as to whether any interest expenditure can be attributed to the securities on which such exempt income was earned. The question of disallowance of such interest u/s 14A would arise only if some expenditure is said to have been incurred in relation to investment in such securities. In this regard, it is observed that the assessee made total investment of [Rs.] 6.33 crore in shares or securities resulting into exempt income. As against that share holder funds stood at [Rs.] 53.79 crore at the end of the year. Thus, it is evident that the amount invested in such shares or securities is far in excess of share holders' funds."

9. Reference was made to the decision of the Delhi High Court in ***CIT vs. Tin Box Co.*** [2003] 260 ITR 637 (Del) to hold that when the assessee had sufficient funds and non interest funds were advanced to a sister concern, no disallowance was justified. Further, the Bombay High Court in ***CIT vs. Reliance Utilities and Power Ltd.*** [2009] 313 ITR 340 (Bom.) had

similarly held that when sufficient non interest funds were available for investment then no disallowance of interest should be made. The Bombay High Court had placed reliance on the decision of ***East India Pharmaceutical Works Ltd. vs. CIT*** [1997] 224 ITR 624 (SC) to the effect that if the assessee had sufficient non interest funds, then investment made in shares and securities resulting in exempt income should not lead to disallowance of interest expenditure, as there was no question of attributing any interest to such investments. Lastly, reference was made to the decision of the Gujarat High Court in ***CIT vs. Suzlon Energy Ltd.*** [2013] 354 ITR 630, to the same effect.

10. Having heard the Counsel for the parties, we feel that the respondent assessee is entitled to succeed on somewhat different grounds and reasons, than those elucidated by the Tribunal.

11. Section 14A of the Act is relevant and reproduced below:-

> "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."

Section 14A of the Act postulates and states that no deduction shall be allowed in respect of expenditure incurred by an assessee in relation to income which does not form part of the total income under the Act. Under sub Section (2) to Section 14A of the Act, the Assessing Officer is required to examine the accounts of the assessee and only when he is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income, the Assessing Officer can determine the amount of expenditure which should be disallowed in accordance with such method as prescribed, i.e. Rule 8D of the Rules (quoted and elucidated below). Therefore, the Assessing Officer at the first instance must examine the disallowance made by the assessee or the claim of the assessee that no

expenditure was incurred to earn the exempt income. If and only if the Assessing Officer is not satisfied on this count after making reference to the accounts, that he is entitled to adopt the method as prescribed i.e. Rule 8D of the Rules. Thus, Rule 8D is not attracted and applicable to all assessee who have exempt income and it is not compulsory and necessary that an assessee must voluntarily compute disallowance as per Rule 8D of the Rules. Where the disallowance or 'nil' disallowance made by the assessee is found to be unsatisfactory on examination of accounts, the assessing officer is entitled and authorised to compute the deduction under Rule 8D of the Rules. This pre-condition and stipulation as noticed below is also mandated in sub Rule (1) to Rule 8D of the Rules.

12. Rule 8D of the Rules, again for the sake of convenience, is reproduced below:-

> "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).
>
> (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 × 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."

Sub Rule (1) categorically and significantly states that the Assessing Officer having regard to the account of the assessee and on not being satisfied with the correctness of the claim of expenditure made by the assessee or claim

that no expenditure was incurred in relation to income which does not form part of the total income under the Act, can go on to determine the disallowance under sub Rule (2) to Rule 8D of the Rules. Sub Rule (2) will not come into operation until and unless the specific pre-condition in sub Rule (1) is satisfied. Thus, Section 14A(2) of the Act and Rule 8D(1) in unison and affirmatively record that the computation or disallowance made by the assessee or claim that no expenditure was incurred to earn exempt income must be examined with reference to the accounts, and only and when the explanation/claim of the assessee is not satisfactory, computation under sub Rule (2) to Rule 8D of the Rules is to be made.

13. We need not, therefore, go on to sub Rule (2) to Rule 8D of the Rules until and unless the Assessing Officer has first recorded the satisfaction, which is mandated by sub Section (2) to Section 14A of the Act and sub Rule (1) to Rule 8D of the Rules.

14. The view and legal ratio expressed above is not being elucidated for the first time. The Delhi High Court in ***Maxopp Investment Ltd. vs. Commissioner of Income Tax*** [2012] 347 ITR 272, has observed:-

> "**Scope of sub-sections (2) and (3) of Section 14A**
> Sub-section (2) of Section 14 A of the said Act provides the manner in which the Assessing Officer is to determine the amount of expenditure incurred in relation to income which

does not form part of the total income. However, if we examine the provision carefully, we would find that the Assessing Officer is required to determine the amount of such expenditure only 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 the said Act. In other words, the requirement of the Assessing Officer embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if the Assessing Officer returns a finding that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Therefore, the condition precedent for the Assessing Officer entering upon a determination of the amount of the expenditure incurred in relation to exempt income is that the Assessing Officer must record that he is not satisfied with the correctness of the claim of the assessee in respect of such expenditure. Sub-section (3) is nothing but an offshoot of sub-section (2) of Section 14A. Sub-section (3) applies to cases where the assessee claims that no expenditure has been incurred in relation to income which does not form part of the total income under the said Act. In other words, sub-section (2) deals with cases where the assessee specifies a positive amount of expenditure in relation to income which does not form part of the total income under the said Act and sub-section (3) applies to cases where the assessee asserts that no expenditure had been incurred in relation to exempt income. In both cases, the Assessing Officer, if satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure, as the case may be, cannot embark upon a determination of the amount of expenditure in accordance with any prescribed method, as mentioned in sub-section (2) of Section 14A of the said Act. It is only if the Assessing Officer is not satisfied with the correctness of the claim of the assessee, in both cases, that the Assessing Officer gets jurisdiction to determine the amount of expenditure incurred

in relation to such income which does not form part of the total income under the said Act in accordance with the prescribed method. The prescribed method being the method stipulated in Rule 8D of the said Rules. 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 Assessing Officer would have to indicate cogent reasons for the same.

Rule 8D

As we have already noticed, sub-section (2) of Section 14A of the said Act refers to the method of determination of the amount of expenditure incurred in relation to exempt income. The expression used is – "such method as may be prescribed". We have already mentioned above that by virtue of Notification No.45 of 2008, dated March 24, 2008, the Central Board of Direct Taxes introduced Rule 8D in the said Rules. The said Rule 8D also makes it clear that 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 asses see; 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 said Act for such previous year, the Assessing Officer shall determine the amount of the expenditure in relation to such income in accordance with the provisions of sub-rule (2) of Rule 8D. We may observe that Rule 8D(1) places the provisions of Section 14A(2) and (3) in the correct perspective. As we have already seen, while discussing the provisions of Sub-sections (2) and (3) of Section 14A, the condition precedent for the Assessing Officer to himself determine the amount of expenditure is that he must record his dissatisfaction with the correctness of the claim of expenditure made by the assessee or with the correctness of the claim made by the assessee that no expenditure has been incurred. It is only when this condition precedent is satisfied that the Assessing Officer is required to determine the amount of expenditure

in relation to income not includable in total income in the manner indicated in sub-rule (2) of Rule 8D of the said Rules.

It is, therefore, clear that determination of the amount of expenditure in relation to exempt income under Rule 8D would only come into play when the Assessing Officer rejects the claim of the assessee in this regard. If one examines sub-rule (2) of Rule 8D, we find that the method for determining the expenditure in relation to exempt income has three components. The first component being the amount of expenditure directly relating to income which does not form part of the total income. The second component being computed on the basis of the formula given therein in a case where the assessee incurs expenditure by way of interest which is not directly attributable to any particular income or receipt. The formula essentially apportions the amount of expenditure by way of interest (other than the amount of interest included in clause (i)) incurred during the previous year in the ratio of the average value of investment, income from which does not or shall not form part of the total income, to the average of the total assets of the assessee. The third component is an artificial figure – one half percent of the average value of the investment, income from which does not or shall not form part of the total income, as appearing in the balance sheets of the assessee, on the first day and the last day of the previous year. It is the aggregate of these three components which would constitute the expenditure in relation to exempt income and it is this amount of expenditure which would be disallowed under Section 14A of the said Act. It is, therefore, clear that in terms of the said Rule, the amount of expenditure in relation to exempt income has two aspects – (a) direct and (b) indirect. The direct expenditure is straightaway taken into account by virtue of clause (i) of sub-rule (2) of Rule 8D. The indirect expenditure, where it is by way of interest, is computed through the principle of apportionment, as indicated above. And, in cases where the

indirect expenditure is not by way of interest, a rule of thumb figure of one half percent of the average value of the investment, income from which does not or shall not form part of the total income, is taken."

15. Even earlier the Bombay High Court in ***Godrej and Boyce Mfg. Co. Ltd. versus Deputy Commissioner of Income Tax*** (2010) 328 ITR 81 (Bom.) had referred to Section 14(2) of the Act and observed:-

"Under sub-section (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" 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 April 1, 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 154."

16. Equally illuminating are the following observations in ***Godrej and Boyce Mfg. Co. Ltd.*** (supra)

> "… However, if the assessee does not maintain separate accounts, it would be necessary for the Assessing Officer to deter-mine the proportion of expenditure incurred in relation to the dividend business (i.e., earning exempt income). It is for exactly such situations that a machinery/method for computing the proportion of expenditure incurred in relation to the dividend business has been provided by way of section 14A(2)/(3) and rule 8D."

17. More important and relevant for us are the observations in ***Godrej and Boyce Mfg. Co. Ltd.*** (supra) on requirement and stipulation of satisfaction

being recorded by the Assessing Officer with reference to the accounts under Section 14(2) of the Act and Rule 8D(1) of the Rules. It was observed:-

> "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. As we shall note shortly hereafter, sub-rule (1) of rule 8D has also incorporated the essential requirements of sub-section (2) of section 14A before the Assessing Officer proceeds to apply the method prescribed under sub-rule (2)."

18. It is in this context we feel that the findings recorded by the CIT(A) and the Tribunal are appropriate and relevant. The clear findings are that the

assessee had sufficient funds for making investments in shares and mutual funds. The said findings coupled with the failure of the Assessing Officer to hold and record his satisfaction clinches the issue in favour of the respondent assessee and against the Revenue. The self or voluntary deductions made by the assessee were not rejected and held to be unsatisfactory, on examination of accounts. Judgments in ***Tin Box Co.*** (supra)***, Reliance Utilities and Power Ltd.*** (supra), ***Suzlon Energy Ltd.*** (supra) and ***East India Pharmaceutical Works Ltd.*** (supra) would be relevant if the satisfaction of the Assessing Officer is in issue, and such question of satisfaction is with reference to the accounts.

19. However, the decisions relied upon by the Tribunal in the case of ***Tin Box Co.*** (supra)***, Reliance Utilities and Power Ltd.*** (supra), ***Suzlon Energy Ltd.*** (supra) and ***East India Pharmaceutical Works Ltd.*** (supra) could not be now applicable, if we apply and compute the disallowance under Rule 8D of the Rules. The said Rule in sub Rule (2) specifically prescribes the mode and method for computing the disallowance under Section 14A of the Act. Thus, the interpretation of clause (ii) to sub Rule (2) to Rule 8D of the Rules by the CIT(A) and the Tribunal is not sustainable. The said clause expressly states that where the assessee has incurred expenditure by way of interest in

the previous year and the interest paid is not directly attributable to any particular income or receipt then the formula prescribed would apply. Under clause (ii) to Rule 8D(2) of the Rules, the Assessing Officer is 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. Pertinently, the amount to be disallowed as expenditure relatable to exempt income, under sub Rule (2) is the aggregate of the amount under clause (i), clause (ii) and clause (iii). Clause (i) relates to direct expenditure relating to income forming part of the total income and under clause (iii) an amount equal to 0.5% of the average amount of value of investment, appearing in the balance sheet on the first day and the last day of the assessee has to be disallowed.

20. However, in the present case we need not refer to sub Rule (2) to Rule 8D of the Rules as conditions mentioned in sub Section (2) to Section 14A of the Act read with sub Rule (1) to Rule 8D of the Rules were not satisfied and the Assessing Officer erred in invoking sub Rule (2), without

elucidating and explaining why the voluntary disallowance made by the assessee was unreasonable and unsatisfactory. We do not find any such satisfaction recorded in the present case by the Assessing Officer, before he invoked sub Rule (2) to Rule 8D of the Rules and made the re-computation. Therefore, the respondent assessee would succeed and the appeal should be dismissed.

The appeals are accordingly dismissed with no order as to costs.

SANJIV KHANNA, J.

V. KAMESWAR RAO, J.

NOVEMBER 25, 2014/km