

**IN THE INCOME TAX APPELLATE TRIBUNAL, KOLKATA 'A' BENCH,
KOLKATA**

Before **Shri M.Balaganesh, Accountant Member** and
Shri S.S. Viswanethra Ravi, Judicial Member

I.T.A. No. 480/KOL/2014
Assessment Year: 2008-09

Deputy Commissioner of Income Tax,..... Appellant
Circle-4, Kolkata, AayakarBhawan,
P-7, Chowringhee Square,
Kolkata-700 069.

-Vs-

M/s. Star Paper Mills Ltd ,..... Respondent
PAN: AAECs 0759B
27, Biplabi Troilakya Maharaj Sarani,
Kolkata-700 001.

Appearances by:
Shri Saurabh Kumar, Addl. CIT, Id.DR for the revenue
Shri G.A. Seshan, Id.AR for the assessee

Date of hearing: 08-03-2017
Date of pronouncement: 22-03-2017

Shri S.S. Viswanethra Ravi , JM:

This appeal by the Revenue against order dt: 06-11-2013 passed by the Commissioner of Income Tax-(Appeals), IV, Kolkata for the assessment year 2008-2009

2. Ground no's 1 is relating to allowance of relief made on account of provisions for leave encashment.

3. The brief facts of the issue are that the AO found that the assessee considered the sum of Rs.2,11,23,952/- and disallowed the same u/s. 43B of the Act. The AO was of the opinion that the difference between computation of assessee and auditor was of Rs. 26,83,073 (Rs.2,38,07,025 – Rs.2,11,23,952) as on 31-03-2008. The AO disallowed the sum of Rs.26,83,073/-u/s 43B of the Act in view of an SLP moved by the department before the Hon'ble Supreme Court.

4. The CIT-A directed the AO to pass an appropriate order in the light of the decision of the Hon'ble Apex Court in the case of Exide Industries Ltd. Relevant findings of the CIT-A in this regard is reproduced herein below:-

4.2 I have carefully considered the submissions of the A.R and noted the A.O's finding in the impugned order. It is indeed correct that the Calcutta High Court in the case of Exide Industries Ltd (supra) had held that Clause (f) of Sec. 43B was inconsistent with the object with which the Sec. 43B was enacted and therefore the same was struck down as ultra virus. Decision of the jurisdictional Calcutta High Court has since been followed with approval by the Kerala High Court in the case of CIT Vs. Hindusthan Latex Ltd. Following the judgments of the Calcutta & Kerala High Courts the ITAT Benches at Bangalore & Jodhpur have also allowed relief to the appellant by deleting the disallowances made in respect of provision for leave encashment. I, however, find that only the SLP filed by the I.T Department against the judgment of the Calcutta High Court in the case of Exide Industries Ltd (supra) was admitted by the Hon'ble Supreme Court, but additionally the Supreme Court also stayed the operation of the said Calcutta High Court judgment and further directed the said assessee to pay the tax demand raised with reference to the addition on account of provision for leave encashment. In the circumstances, I find that at this point in time judgment of the Calcutta High Court does not operate as a binding judicial precedent for the judicial authorities functioning under the jurisdiction of the Hon'ble Calcutta High Court. In the circumstances, being judicial functionary operating within the jurisdiction of the Calcutta High Court I am not only expected to abide by the judgment of the Calcutta High Court, but I also need to follow the orders passed by the Apex Court in relation to the judgment of the Calcutta High Court. I find that only the judgment of the Calcutta High Court, relied upon by the appellant is stayed by the Apex Court but the appellant concerned was also directed to pay the tax demand relating to said issue. On these facts, therefore, I find that the ratio decided of the Calcutta High Court judgment cannot be used as a binding precedent till the I.T Department's appeal is decided by the Supreme Court. At the same time, I also find that the issue with regard to allowability of the Provision for leave encashment has not been decided by the Hon'ble Apex Court one way or the other & the issue of allowability is pending before the Supreme Court for its decision. In the circumstances, to meet the ends of justice I direct that while giving effect to the appellate order the AO will take into consideration the judgment that will ultimately be rendered by the Supreme Court in the departmental appeal in the case of CIT Vs. Exide Industries Ltd. Since the time limit does not operate in the matter of giving effect to the directions of the appellate authority, I direct that the AO shall pass an appropriate order either confirming the disallowance u/s. 43B(f) or allowing the relief in the light of the decision of the Apex Court in the case of Exide industries Ltd. "

5. At the time of hearing before us the Id.DR appearing on behalf of revenue has relied on the order of the AO in making disallowance u/s. 43B of the Act on account of leave encashment amounting to Rs.26,83,073/- in the assessment proceedings.

6. On the other hand, the Id.AR of the assessee submits before us that the issue in hand may be restored to the file of the AO in view of SLP pending before the Hon'ble Calcutta High Court.

7. Heard rival submissions and perused the material on record. We find that this Tribunal decided the issue therein is being similar to the issue on hand covering the grounds as raised in no-1 and the relevant portion of which is reproduced herein below:

25. The issue raised in Ground No. 8 relates to the disallowance of 1.51 crores made by the Assessing Officer and confirmed by the Id. CIT(Appeals) on account of provision made by the assessee for leave encashment.

26. The assessee-Company during the year under consideration had made a provision of Rs.1.51 crores for leave encashment on the basis of an actuarial valuation and the same was claimed as deduction by relying on the decision of the Hon'ble Calcutta High Court in assessee's own case reported in 292 ITR 470 and the decision of the Hon'ble Supreme Court in the case of Bharat Earth Movers reported in 245 ITR 428. The Assessing Officer, however, disallowed the claim of the assessee for provision of leave encashment relying on the Clause (f) inserted in Section 43B by the Finance Act, 2001 w.e.f. 1st April, 2002. The Id. CIT(Appeals) confirmed the said disallowance. The assessee challenged the constitutional validity of Clause (f) inserted in Section 43B before the Hon'ble Calcutta High Court by way of a Writ Petition and although the same was initially dismissed by the Single Bench, it was admitted and ruled in favour of the assessee by the Division Bench of the Hon'ble Calcutta High Court by holding that the introduction of Clause (f) to Section 43B is ultra virus of the Act in the absence of disclosure of the objects and being inconsistent with the basic intent of Section 43B. Thereafter the Department filed the SLP against the decision of the Hon'ble Calcutta High Court and while admitting the same, the Hon'ble Supreme Court vide its judgment dated 08.09.2008 stayed the judgment of the Hon'ble Calcutta High Court until further orders.

27. At the time of hearing before us, the Id. Counsel for the assessee has contended that even though the decision of the Hon'ble Calcutta High Court holding Clause (f) of Section 43B as ultra virus is stayed by the Hon'ble Supreme Court while admitting the SLP filed by the Revenue, the same has not been reversed and this Tribunal, therefore, is bound to follow the same being a binding precedent. He has also contended that the decision of the Hon'ble Calcutta High Court was stayed by the Hon'ble Apex Court vide its judgment dated 08.09.2008 until further orders and there being another Interim Order passed by the Hon'ble Supreme Court on 08.05.2009, the stay granted earlier stands automatically vacated. A copy of the said interim order dated 08.05.2009 is placed on record before us, the contents of which are extracted below:- "Pending hearing and final disposal of the Civil Appeal,

Department is restrained from recovering penalty and interest which has accrued till date. It is made clear that as far as the outstanding interest demand as of date is concerned, it would be open to the Department to recover the amount in case Civil Appeal of the Department is allowed. We further make it clear that the assessee would during the pendency of this Civil Appeal, pay tax as if section 43B(f) is on the Statute Book but at the same time it would be entitled to make a claim in its returns".

28. We have carefully perused the Interim Order dated 8th May, 2009 passed by the Hon'ble Supreme Court in the matter. It is observed that the Hon'ble Apex Court in the said order has made it clear that the assessee, during the pendency of the Civil Appeal, would pay tax as if Section 43B(f) is on the Statute Book, but at the same time, it would be entitled to make claim in its return. Keeping in view all these developments, the Coordinate Bench of this Tribunal in the case of Dy. CIT -vs.- BLA Industries Pvt. Ltd. (ITA No. 1434/KOL/2012 dated 16.01.2015) has restored the similar issue to the file of the Assessing Officer with a direction to await till the final decision of the Hon'ble Supreme Court on the issue and then to decide the issue accordingly. Following the said decision of the Coordinate Bench, we restore this issue to the file of the Assessing Officer with the similar direction. Ground No. 8 is accordingly treated as allowed for statistical purposes.

8. Taking into consideration the order *supra*, we remand the issue to the file of AO to decide the same in accordance with the Judgment of the Hon'ble Supreme Court that may be passed in Civil Appeal filed by the Revenue. Ground no-1 is allowed for statistical purposes.

9. Ground no. 2 is relating to restriction of disallowance made u/s. 14A of the Act to Rs.1,51,764/- by the CIT-A.

10. The brief facts of this issue are that during the assessment proceedings the AO found that the assessee earned dividend income of Rs.1,20,000/- during the A.Y under consideration. The AO found that the assessee disallowed on its own an amount of Rs.1,45,765/- at 5% of dividend income i. e Rs. 6000/- as other expenses relatable to earning such dividend income. In explanation to the applicability for S.14A r.w.r 8D for making of such disallowance, the assessee submitted that the main business of assessee is manufacturing of paper and investments and in respect of which dividend was earned were purchased years back with its own funds. However, being not satisfied with such contention of assessee, the AO applying Rule 8D(iii) of the

IT Rules computed the disallowable expenditure at Rs. 13,76,000/- [Rs.15,27,764 (-) Rs.1,51,764/-] as made/computed by the assessee.

11. The CIT-A deleted such disallowance by observing that the AO could not establish the real and approximate nexus between the expenses and the dividend earned. Relevant findings of the CIT-A are reproduced herein below:-

5.2 I have considered the submissions of the appellant and perused the details on record. I note that the appellant held Investments in shares of other bodies corporate which were substantial in value. I also note that in the impugned order the A.O. in principle accepted the appellant's contention that investments were made out of appellant's own funds and no part of the borrowed funds were utilized. Accordingly, the AO did not make disallowance out of interest paid. From the details furnished, I further note that during the F.Y. 2007-08 the appellant earned dividend of Rs.1,20,000/- from the shares which the appellant held in Bank of Baroda. The said investment was acquired in the earlier year. Dividend was received only on 2 occasions which was directly credited to the appellant's account through ECS mode. I therefore find force in the appellant's explanations that for earning or making dividend income of Rs.1,20,000/- the appellant was not required to incur expenses on collecting or realizing the dividend. Save and except 2 occasions on which dividend was received the appellant did not earn tax-free income on any other occasion during the entire F.Y. 2007-08. In the circumstances all that the appellant was expected to incur expenditure on, related to accounting of dividend received on 2 occasions. The appellant fairly estimated such expenditure at Rs.6,000/-. The appellant's estimate of the amount disallowable u/s 14A appeared to be fair and reasonable having regard to the totality of the facts and circumstances of the case. It has been held by judicial authorities that expenditure which can be disallowed u/s 14A must have some real, rational and proximate nexus with earning of tax-free income. Rule 8D is a rule of evidence which prescribes a mathematical formula for making disallowance. The presumptive rule of evidence contained in Rule 8D is however rebuttable in nature & the assessee can rebut the presumption by bringing on record relevant facts to establish that expenditure was in fact not incurred to the extent envisaged by Rule 8D. Before Rule 8D(2) is invoked in it is necessary for the A.O to first come to a rational conclusion that the expenditure which the appellant incurred during the relevant year had some real & actual nexus with earning of tax-free income. Merely because an appellant in its Profit & Loss A/c debits expenses in respect of his business activities and in the same P & L Account the appellant also credits dividend income; then such fact by itself is not sufficient for the AO to disallow part of the expenses which the appellant has otherwise incurred in relation or in connection with his business activities having no connection with earning of tax-free income. In the garb of making disallowance in conformity with the mathematical formula incorporate in Rule 8D(2) the AO is not permitted to disallow expenses which the assessee has legitimately incurred in connection with his business activities which yield him taxable income. It is for these reasons language employed in Sec. 14A as also in Rule 8D(1) require that before invoking the mathematical formula incorporated in Rule 8D(2) the AO must have regard to the appellant's explanation and also to the entries in the appellant's books. The AO must take into consideration the factual aspects of the appellant's case while objectively dealing with the explanations furnished by the appellant.

5.3 In the present case of the appellant it had earned dividend of Rs.1,20,000/- only from investment in shares of one Company i.e. Bank of Baroda. The dividend was received only on 2 occasions. Dividend was directly credited to appellant's account through ECS. The investment was brought forward from the earlier year. Moreover, by A.O's own admission the investments were made in the earlier years without utilizing borrowed funds. On these facts, therefore, it is beyond comprehension as to on what basis the A.O. came to conclusion that the assessee had incurred expenses of Rs.15,27,764/- for earning dividend of only Rs.1,20,000/-. The A.O's finding should have established same rational and real nexus between any particular item of expenditure to the order of Rs.15,27,764/- with earning of dividend of mere Rs.1,20,000/-. I however, find that save and except mechanically applying mathematical formula incorporated in Rule 8D(2)(iii) the A.O. did not bring on record any material which in any manner proved any rational and real nexus between any specific items of expenditure with earning of dividend of Rs.1,20,000/-. The ITAT Kolkata Bench in the case of Hindusthan Paper Corporation Ltd Vs

DCIT in I.T.A. No. 47/Kol/2012 for the Asst Year 2008-09 had considered a similar issue. The appeal decided by the Tribunal also related to A.Y. 2008-09 being the year in which Rule 8D came in force. In that case the appellant, a Government Undertaking, had received dividend only on one occasion from its subsidiary through ECS mode. By invoking provisions of Rule 8D(2)(iii) the A.O. disallowed Rs.1,02,59,650/-. Taking into consideration the explanations put forward by the assessee and having regard to the fact that the dividend was received from the subsidiary only on one occasion through ECS the ITAT did not find any merit in the disallowance made by the A.O. by mechanical application of Rule 8D(2)(iii). The Tribunal accepted the submissions of the assessee that even after introduction of Rule 8D, it was necessary for the A.O. to establish some real and proximate nexus between incurring of expenses and earning of dividend and in absence of such nexus; disallowance only based on arithmetical formula; incorporated in Rule 8D(2)(iii) was held to be unsustainable. The facts of the case decided by the ITAT Kolkata Bench are almost identical to the facts of the appellant's case. I find that save and except applying the formula incorporated in Rule 8D(2)(iii) the A.O. did' not bring on record any material to correlate any specific item of expenditure with earning of dividend. The dividend was received only from one Company and through ECS mode without incurring any collection charges. On these facts therefore I have no hesitation in holding that the facts of the appellant's case did not justify disallowance to the extent of Rs.15,27,764/- as made by applying Rule 8D(2)(iii). For the reasons set out herein before, therefore I do not find merit in A.O's action of disallowing additional sum of Rs.13,76,000/- u/s 14A. The disallowance of Rs.13,76,000/- is accordingly deleted. Ground No. 2 is allowed."

12. The Id. DR relied on the order of AO. On the contrary, the Ld. AR of the assessee submits that it is covered by the order of this Tribunal in the case of *REI Agro Ltd supra* in ITA No. 1331/Kol/2011 reported in 144 ITD 141 (Kol).

13. Heard rival submissions and perused the material available on record. We find that except observing that the assessee has earned dividend income and nothing was shown by the AO in his order that the assessee earned income as dividend income and resorted to apply the method as provided under rule 8D(2)(iii) and computed the expenses basing on total average investment as opening and closing balance respectively and disallowed the impugned amount. The contention of the assessee before the CIT-A as well as before us, was that the assessee did not derive dividend income from all investments and such investments were made out of its own funds. In this regard we may refer to the said decision as relied by the Ld.AR in the case of *supra*, wherein the Tribunal held that the dividend earned out of investments would become the subject matter to be considered for computing the expenses by the method as provided under Rule 8D when such investment yields dividend income. It means to show that when there is no dividend income application of Rule 8D does not arise at all. For better understanding relevant portion of which is reproduced herein below:-

8.1 Thus, not all investments become the subject-matter of consideration when computing disallowance under section 14A read with rule 8D. The disallowance under section 14A read with rule 8D is to be in relation to the income which does not form part of the total income and this can be done only by taking into consideration the investment which has given rise to this income which does not form part of the total income. Under the circumstances, the computation of the disallowance under section 14A read with rule 8D(2)(ii), which is issue in the assessee's appeal, is restored to the file of the AO for recomputation in line with the direction given above. No disallowance under section 14A read with rule 8D(2)(i) and (ii) can be made in this case."

14. Respectfully following the co-ordinate bench decision of this tribunal supra, we direct the Id. AO to consider disallowance in terms of Rule 8D(2)(iii) of the I.T Rules by considering only those investments, which had yielded dividend income. Hence, the ground no.2 raised by the revenue is partly allowed.

15. In the result, the appeal filed by the revenue is partly allowed for statistical purpose.

Order pronounced in the open Court on 22-03-2017

Sd/-

M.Balaganesh
Accountant Member

Sd/-

S.S. Viswanethra Ravi
Judicial Member

Date: 22-03-2017

Copies of the order forwarded to :

- (1) The department: Deputy Commissioner of Income Tax, Cir-4, Kolkata, P-7 Chowringhee Square, Kolkata-69.
- (2) The assessee: M/s. Star Paper Mills Ltd 27 Biplabi Troilakya Maharaj Sarani, Kolkata-700 001.
- (3) Commissioner of Income-tax (Appeals)-I, Kolkata
- (4) Commissioner of Income Tax, Kolkata
- (5) The Departmental Representative
- (6) Guard File

**PP/SPS

By order

Assistant Registrar,
Income Tax Appellate Tribunal
Kolkata