

आयकर अपीलीय अधिकरण, 'डी' न्यायपीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
"D" BENCH, CHENNAI

श्री चंद्र पूजारी, लेखा सदस्य एवं
श्री चल्ला नागेन्द्र प्रसाद, न्यायिक सदस्य के समक्ष
BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER &
SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER
आयकर अपील सं./ **I.T.A. No.2277/Mds/2014**
(निर्धारण वर्ष / Assessment Year : 2008-2009)

M/s. iNautix Technologies India Pvt. Ltd, 10 th floor, Tidal Park, No.4, Canal Bank Road, Taramani, Chennai 600 113. (PAN No.AAACI 6177K)	Vs	The Assistant Commissioner of Income Tax, Company Circle II(3), Chennai
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ITA No.2625/Mds/2014
(निर्धारण वर्ष / **Assessment Year : 2008-2009**)

The Assistant Commissioner of Income Tax, Company Circle II(3), Chennai	vs	M/s. iNautix Technologies India Pvt. Ltd, 10 th floor, Tidal Park, No.4, Canal Bank Road, Taramani, Chennai 600 113. (PAN No.AAACI 6177K)
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(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

Assessee by	:	Dr. Anitha Sumanth, Advocate
Department by	:	Shri. A. Sreekanth, IRS, JCIT

सुनवाई की तारीख/Date of hearing	:	04.06.2015
घोषणा की तारीख /Date of Pronouncement	:	19.06.2015

आदेश / O R D E R**PER CHANDRA POOJARI, ACCOUNTANT MEMBER**

The assessee and the Revenue are in cross appeals against the order of the Commissioner of Income Tax (Appeals)-II, Chennai, dated 19.05.2014 for the assessment year 2008-2009.

2. The first ground raised by the assessee is to regard to disallowance u/s.14A of the Income Tax Act.

3. The facts of the case are that the assessee company was found to have invested an amount of ₹92.35 crores in shares/funds as on 31.03.2008, as could be seen from the investments of the balance during the financial year 2007-08, and also earned dividends of ₹4,92,32,251/- and claimed the same as exempt u/s.10(34) of the Act. However the assessee has not segregated any expenditure attributable to such investments whose income (dividends income) is exempt from tax. Hence the Assessing Officer invoked the provisions of sec.14A of the Act read with rule 8D and determined the expenditure attributable for earning such exempt income at ₹37,28,239/- and disallowed the same, both under the regular provisions of the Act as well as

u/s.115JB of the Act. The relevant portion of the assessment order held as under:-

6. Disallowance of expenditure attributable to earning of Exempted Income:

During the period under reference the Assessee Company has received a dividend of ₹4,92,32,251/- which has been claimed as exempt u/s 10(34). However, the assessee has not considered any expenditure attributable towards the earning of such exempted Income. A reasonable expenditure is necessary to earn the exempt income considering the human resources cost, interest cost of the investment and other relevant cost which should go into earning of the exempt income. The Assessee was accordingly asked to give details of the expenditure incurred on earning the above income in the course of hearing. The Assessee vide written submission filed on 02-12-11 stated mainly as follows:

i)The investments in mutual funds were not made out of borrowed funds but surplus funds available with the Company.

ii) The Company did not incur any expenditure towards banker charges, brokerage or demat charges during the subject F. Y. for earning the income.

6.1 I have carefully gone through the submission of the Assessee. Under Sec. 14A, no deduction shall be allowed In respect of expenditure incurred by the assessee in relation to Income which does not form part of total income. Again a per Rule 8D of Income Tax Rules, 1962 the expenditure in relation to income which does not form part of the total income shall be the aggregate at 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

$$A \times \frac{B}{C}$$

Where A= amount of expenditure by way of interest other than the amount of interest

include 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 of the previous year;

(iii) an amount equal to one-half percent 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 1st day of the previous year.

Accordingly, the expenses incurred for earning the exempt income as prescribed vide rule 8D of IT Rules, 1962 is calculated as below:

Amount of interest expenditure: Nil.
Average value of investment, income from which his exempt.

$$\frac{92,35,12,831 + 55,77,81,586/-}{2} = ₹74,56,47,712/-$$

$$\frac{1}{2} \% \text{ of } ₹74,56,47,712/- = ₹37,28,239/-$$

Accordingly the amount of ₹37,28,239/- is added back with the total income being the expense incurred for earning the dividend income exempt u/s.10(34).

Accordingly, Assessing Officer added back an amount of ₹37,28,239/- with the total income being the expense incurred for earning the dividend income exempt u/s.10(34). Aggrieved, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals).

4. On appeal, the Commissioner of Income Tax (Appeals) observed that the assessee's total investments in shares/funds were ₹92.35 crores as on 31.03.2008 (and ₹55.77 crores as on 31.03.2007), as could be seen from the investments of the balance during the financial year 2007-08, and also earned dividends of ₹4,92,32,251/- and claimed the same as exempt u/s.10(34) of the Act.

4.1 The Commissioner of Income Tax (Appeals) observed that the assessee was not maintaining any separate books of accounts for the investments in shares/funds. Nor there was a separate establishment to look after the investments in shares/funds. The assessee may be having substantial interest free own funds (in the form of capital/reserves and surpluses etc). But this does not mean that the investments are made only from these own interest free funds, especially if the books are not maintained separately. Further, all the funds, i.e. the interest-free own funds and the interest bearing borrowed funds are put into a common pool of funds. From this common kitty all the outgoings (i.e. investments in shares, regular business expenses etc) are met with. In other words, once the funds, i.e. whether the

interest- free own funds or the interest bearing borrowed funds, are put into a common pool of funds, they will lose their distinction and all types of funds will be treated alike. In such a situation, the only way to ascertain the investments made from the borrowed funds, if any, was on a proportionate basis. Therefore, the interest expenses, which could not be directly linked to any activity, are to be treated as common interest expenses and considered in the step-2 of the formula given in Rule-8D for the purpose of attributing the indirect interest burden on the investments made, on a proportionate basis. Even Bombay High Court, in the case of *Godrej Boyce Mfg Co Ltd v. CIT*, decided on 12.08.2010, held that Sec. 14A(2) & (3) of the Act, was constitutionally valid and is applicable from assessment year 2008-09 onwards. In this case, the High Court has clearly and categorically held that

"the provisions of Rule 8D of the Income Tax Rules which have been notified with effect from 24 March 2008 shall apply with effect from Assessment Year 2008-09".

4.2. He observed that the disallowance of expenses u/s.14 A r. w. rule 8D is in relation to the earning of the exempt income and not in relation to the exempt income earned as such. The

disallowance of expenses is always in relation to the efforts made for earning such exempt income and not proportionate to the exempt income earned. It is particularly so because, in some years the income so earned may be less or nil. Therefore, the disallowance to be computed should always be with reference to the investments made in such activity and the effort made therein, as held by Special Bench of ITAT Delhi in the case of Cheminvest Ltd. v. ITO [2009] (121 ITD 318)(Del)(SB) / (124 ITJ 577)(Del) (SB), wherein it was held as under:

Cheminvest Ltd. v. ITO [2009] (121 ITD 318)(Del)(SB)

Section 14A, read with section 10(34), of the Income-tax Act, 1961 - Expenditure incurred in relation to income not includible in total income - Assessment year 2004-05

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Whether since dividend income is exempted from tax by virtue of section 10(34), interest paid on borrowed capital utilized in purchase of shares, being expenditure incurred in relation to dividend income not forming part of assessee's total income, cannot be allowed as a deduction - Held, yes-

Whether such disallowance under section 14A can be made even in a year in which no exempt income has been earned or received by assessee - Held, yes

4.3 Thus, from the above decision it was clear that the amount of exempt income earned during the year was not relevant for the purpose of disallowance of expenses u/s.14A read with rule 8D. What was to be seen the amount of investments made and the efforts taken by the assessee in the said process. Therefore the amount of disallowance

was to be worked out proportionate to the investments made and the expenses (either direct or indirect) involved in the process, even if there are no such exempt income earned during the year.

4.4 As could be seen from the P&L account, the assessee has several activities including investments in shares. For the purpose of making these investments etc, the same management, manpower, machinery and infrastructural facilities of the assessee are being used. Hence, there was an element of expenditure involved in the process. This expenditure may not be direct. Thus, there was an expenditure involved in making these investments. Therefore, there was a need to identify and apportion a reasonable amount of expenses as attributable for earning the exempted income. For this purpose reliance placed on the following decisions:

Dy. CIT vs. SREI International Finance Ltd. (2006) 10 SOT 722 (Delhi) – Tribunal:-

In light of clear provisions of section 14A, even in case it is not possible to identify expenses incurred in earning income which does not form part of total income, disallowance has to be made on some basis.

Marezban Bharucha v. Asstt. CIT (2007)12 SOT 133 (Mum.-Trib):

Where an expenditure is composite one, i.e., relating to taxable receipts as well as non-taxable receipts, Assessing Officer is duty-bound to disallow proportionate amount of expenditure relatable to non-taxable or exempted income by invoking provisions of section 14A.

4.5 According to the Commissioner of Income Tax (Appeals) in order to arrive at a reasonable amount of expenditure, which may vary from case to case and situation to situation, the legislature, after taking various factors into consideration, came to a conclusion that such expenses can be reasonably calculated @ 0.5% of the average investments made by the assessee. For this purpose, the legislature has arrived at a common formula to calculate the expenses @ 0.5% of the average investments made as per step-3 of the formula given in Rule-8D. Accordingly the legislature incorporated and introduced the Rule-8D.

4.6 Further, as could be seen from the assessment order, the Assessing Officer has analysed the assessee's activity of investing in shares and observed that there will be some element of expenditure, both in terms of financial burden (interest element) as well as the in terms of use of manpower and infrastructural facilities in making the investments in shares/funds. Hence there was a satisfaction

of the Assessing Officer that there was some element of expenses incurred by the assessee in relation to the investments in shares and earning the exempt income, which needs to be quantified and disallowed u/s.14A of the Act. Accordingly, as provided u/s.14A of the Act the Assessing Officer quantified the said expenses at ₹37,28,239/-, by using the rule 8D, and disallowed u/s.14A of the Act.

4.7 According to the Commissioner of Income Tax (Appeals) observed that the Assessing Officer was satisfied that there was an element of expenses involved in making investments whose income was exempt from tax. The Assessing Officer was duty bound to invoke the provisions of Rule-8D. Once the provisions of Rule- 8D are invoked, the Assessing Officer has no option but to arrive at the expenses @ 0.5% as per step-3 of the formula which was mandatory. In fact, the Assessing Officer in his order has clearly stated these facts before invoking the provisions of section 14A r.w.r.8D. Hence the Assessing Officer rightly invoked the Rule-8D and arrived at the disallowance of expenses u/s.14A r.w.Rule-8D.

4.8 In view of the above he confirmed the Assessing Officer's action of determining the expenses attributable for earning exempt income at ₹37,28,239/- u/s.14A, r.w.Rule 8D, both under the regular provisions of the Act as well as u/s.115JB of the Act. Against this, the assessee is in appeal before us.

5. We have heard both the parties and perused the material on record. In this case the Id. Authorised Representative for assessee submitted that no disallowance is warranted u/s.14A r.w. Rule 8D, since the interest free funds available with the assessee in the form of share capital, reserve and surplus, and the same were used for the purpose of investment in assets, the income from which shall not or does not form part of the total income. She drew our attention to the financial statement for the year ending 31.03.2008, stating that the assessee is having share capital, reserve and surplus that are interest free funds. The sources of funds are under;-

	Schedule	31 st March, 08	31 st March, 07
SOURCES OF FUNDS			
Shareholders' funds			
Share Capital	1	181,825,600	181,825,600
Reserves and surplus-Profit and Loss account		2,659,340,503	2,204,527,633
Total		2,841,166,103	2,386,353,233
APPLICATION OF FUNDS			
Fixed assets	2		

Gross block		728,324,538	626,273,101
Less: Accumulated depreciation		523,981,710	455,974,749
Net block		204,342,828	170,298,352
Capital work in progress		568,934	-----
Investments	3	2,298,461,187	1,899,618,086
Deferred tax assets	4	33,063,233	33,881,196
Current assets, loans and advances			
Interest accrued on investments		82,388,219	81,956,301
Sundry debtors	5	173,057,736	174,539,282
Cash and bank balances	6	165,586,832	2,874,554
Other current assets	7	16,326,220	54,718,411
Loans and advance	8	159,978,633	99,903,794
		-----	-----
		597,337,640	413,992,342
Less: Current liabilities and provisions	9	292,607,719	131,436,743
		-----	-----
Net Current assets		304,729,921	282,555,599
		-----	-----
Total		2,841,166,103	2,386,353,233
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The Id. Authorised Representative for assessee submitted that the assessee is having enough interest free funds to make investments which are yielding tax free income not used the borrowed funds to make such investment.

6. On the other hand, the Departmental Representative relied on the orders of the Commissioner of Income Tax (Appeals).

7. We have heard the rival submissions. Admittedly, in this case the assessee is having enough interest free funds in the form of share

capital and reserve and surplus. The amount of investment made by the assessee is less than the interest free funds. Further, Rule 8D was introduced with effect from 24.03.2008, which was prospective in operation and cannot be regarded as being retrospective as held by Delhi High Court in the case of *Maxopp Investment Ltd vs. CIT 347 ITR 272*. However, incurring certain administrative expenses cannot be ruled out. Accordingly, placing reliance on the judgment of the jurisdictional High Court in the case of *Simpson & Co Ltd in T.C. No.2621/2006, dated 15.10.2012*, we direct the Assessing Officer to disallow 2% of exempt income as income expenditure towards earning that income. This ground of the assessee is partly allowed.

8. The next ground for our consideration is that the Commissioner of Income Tax (Appeals) erred in not adjudicating the following ground. Admittedly, the assessee raised the following ground before the Commissioner of Income Tax (Appeals), which was not adjudicated by the Commissioner of Income Tax (Appeals).

"That the Commissioner of Income Tax (Appeals) erred on facts and in law in not adjudicating the plea raised by the appellant, without prejudice, to the effect that disallowance, if any, under section 14A should go to increase the profit derived from the eligible undertaking(s)/unit(s) for purpose of sections 10A of the Act."

9. In our opinion, this issue is squarely covered by the order of the Bombay High Court in the case of *CIT vs. M/s. Gem Plus Jewellery India Ltd 330 ITR 175*, wherein it was held that the assessee was entitled to exemption u/s.10A with reference to addition or disallowance of various payments, as the plain consequence of the disallowance and add back made by the Assessing Officer is an increase in the business profits of the assessee and the same to be considered for the purpose of computation of deduction u/s.10A of the act. Adopting the similar principle, we are inclined to direct the Assessing Officer to consider the disallowance u/s. 14A r.w Rule 8D as part of business profit so as to compute deduction u/s.10A of the Act. In the result, the assessee appeal is partly allowed.

10. Coming to the appeal of the Revenue, the grievance is that the Commissioner of Income Tax (Appeals) erred in holding that travelling expenses incurred in foreign currency are to be reduced from total turnover also for the purpose of computation of deduction u/s.10A of the Act.

11. After hearing both sides, we are of the opinion that this issue is squarely covered by the order of the Special Bench Chennai in the case of *ITO vs. SAK Soft Ltd, 121 TTJ 865 (SB)*, wherein it was held that for the purpose of applying the formula under-sub-section (4) of

section 10B, the freight, telecom charges or insurance attributable to the delivery of the articles or things or computer software outside India or expenses, if any, incurred in foreign exchange in providing the technical services outside India are to be excluded both from the export turnover and from the total turnover, which are the numerator and the denominator respectively in the formula.

12. Placing reliance on the above order of the Tribunal, we are inclined to decide the issue in favour of the assessee and against Revenue. In the result, the appeal by the Revenue is dismissed.

13. In the result, the appeal of the Revenue is dismissed and assessee's appeal is partly allowed.

Order pronounced on Friday, the 19th day of June, 2015, at Chennai.

Sd/-

(चल्ला नागेन्द्र प्रसाद)

(CHALLA NAGENDRA PRASAD)

न्यायिक सदस्य/ JUDICIAL MEMBER

चेन्नई/Chennai.

दिनांक/Dated:19.06.2015.

KV

आदेश की प्रतिलिपि अग्रेषित/Copy to: 1. अपीलार्थी/Appellant 2.प्रत्यर्थी/ Respondent 3. आयकर आयुक्त (अपील)/CIT(A) 4. आयकर आयुक्त/CIT 5. विभागीय प्रतिनिधि/DR 6. गार्ड फाईल/GF.

Sd/-

(चंद्र पूजारी)

(CHANDRA POOJARI)

लेखा सदस्य/ ACCOUNTANT MEMBER

