IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH: 'C' NEW DELHI

BEFORE SHRI SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER
&
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA Nos.-2192, 2193 & 2194/Del/2013
(Assessment Year: 2007-08, 09-10 & 08-09)

Goyal MG Gases P. Ltd. A-38, 1st Floor, Mohan Cooperative Indl. Estate, Main Mathura Road, New Delhi. AABCG6972B	vs	ACIT Cent. Circle 15, New Delhi.

Assessee by	**S/Sh. R.S. Singhavi, CA** **Satyajeet Goel, CA**
Revenue by	**Sh. A.K. Saroha, CIT DR**

ORDER

PER SUDHANSHU SRIVASTAVA, JUDICIAL MEMBER:

ITA No. 2192 is preferred by the assessee against the order dated 12/02/2013 passed by the Ld. Commissioner of Income Tax (Appeals)-II, New Delhi for AY 2007-08. ITA No. 2194 pertains to AY 2008-09 and has been preferred by the assessee against the order dated 13/02/2013 passed by the Ld. CIT (Appeals)-II, New Delhi, whereas ITA No. 2193 pertains

to AY 2009-10 and has been preferred by the assessee against the order dated 13/02/2013 passed by the Ld. CIT (Appeals)-II, New Delhi. Since the issues involved in all the three appeals are identical, they were heard together and they are being disposed of through this common order.

2. ITA No. 2192/Del/2013 - AY 2007-08: The assessee filed return of income declaring an income of Rs. 7,57,69,837/- which was subsequently revised to Rs. 7,80,72,146/-. The assessment u/s 143(3) was finalized at an income of Rs. 11,52,23,468/- after making the following disallowances:

i. Advertisement expenses disallowed - Rs. 54,857/-
ii. Legal and Professional charges disallowed - Rs. 53,90,821/-
iii. Sales Promotion expenses disallowed - Rs. 8,17,094/-
iv. Repairs and maintenance expenses disallowed - Rs. 18,93,157/-
v. Disallowance u/s 14A - Rs. 2,89,95,395/-.

3. Aggrieved the assessee preferred an appeal before the First Appellate Authority. On the issue of disallowance of legal and professional charges amounting to Rs. 53,90,821/-, the Ld. CIT(A) upheld the addition on the ground that since the co-relation between the bills/vouchers and the business purpose was not explained, 20% of the expenses as disallowed by the AO was to be upheld. On the issue of disallowance of sales promotion expenses amounting to Rs. 82,17,094/-, the Ld. CIT(A) held that the AO had given a specific finding that party wise details along with the nature of expenses were never filed before him and hence the disallowance was to be upheld. On the issue of disallowance of repairs and maintenance expenses of Rs. 18,93,157/-, the Ld. CIT (Appeals) however, accepted the assessee's claim and deleted the addition. On the issue of disallowance of Rs. 2,89,95,395/- u/s 14A, the Ld. CIT(Appeals) held that the calculation adopted by the AO could not be faulted with and this addition was also upheld.

4. Aggrieved assessee has now preferred an appeal before the Tribunal and has raised the following grounds of appeal:

1(i) *That on the facts and circumstances of the case, the CIT (A) was not justified in. confirming adhoc disallowance of Rs. 53,90,821/- to the extent of 20% of the claim relating to legal and professional charges.*

(ii) That entire claim is for the purpose of business and duly supported by details and evidences and disallowance of claim is without proper appreciation of facts and submission of the appellant.

2(i) That on the facts and circumstances of the case, the CIT(A) was not justified in confirming adhoc disallowance of 20% to the extent of Rs. 78,17,094/- relating to sales promotions expenses.

(ii) That the entire claim is for the purpose of business and there is no justification for adhoc disallowance.

3(i) That on the facts and circumstances of the case, the CIT(A) was not justified in confirming disallowance u/s. 14A to the extent of Rs. 2,89,95,395/- *even though there is no finding that any part of claim of expenses is relatable to claim of exempt income on account of dividend from mutual funds.*

(ii) That rule 8D is not applicable in the year under reference and as such there could be no disallowance on the basis of provisions of rule 8D.

(iii) That whole basis of disallowance is illegal, arbitrary and without proper consideration of provisions of sec. 14A of

the Income Tax Act, 1961.

(iv) That even otherwise, the working of disallowance under rule 8D is also not justified.

4. That orders of the lower authorities are not justified on facts and same are bad in law.

5. The Ld. AR submitted that the genuineness of the legal expenses has at no place been doubted by the AO. He drew our attention to page 10 of the PB which contains the detailed printout of the legal and professional charges incurred by the assessee. It was further submitted that in case of audited accounts *adhoc* disallowance was not warranted without pointing out specific defects. On the issue of sales promotion expenses he drew our attention to a chart on page 11 of the PB which contained the details of the sales promotion expenses and submitted that the complete details were submitted before the AO but even then *adhoc* disallowances have been made in which even the magazine subscription fee has been disallowed. On the issue of 14A disallowance, the Ld. AR submitted that the year under appeal is AY 2007-08 in which Rule 8D of the Income Tax Rules, 1962 was not applicable. He further

submitted that in this particular year there was no exempt income earned by the assessee and the satisfaction before disallowance u/s 14A has also not been properly arrived at by the AO and further there was no disallowance *suomoto* by the assessee itself u/s 14A and hence the disallowance under 14A was not legally sustainable. He also drew our attention to page 12 of the PB which contains details of investments and the redemption of the investments during AY 2007-08.

6. In response, the Ld. DR submitted that as far as the disallowance of legal expenses were concerned, the AO had adopted a reasonable and pragmatic basis for the disallowance and although the assessee had been given an opportunity to furnish the details, no details were forthcoming and hence the disallowance was justified. On the issue of disallowance of sales promotion expenses it was submitted that since the complete details were not filed before the AO, there was no way in which any specific item of disallowance could be pointed out and hence, in absence of details, the disallowance was fully

justified. On the issue of 14A disallowance, it was submitted that the onus is on the assessee to prove that no expenditure was incurred on earning exempt income which has not been discharged and although Rule 8D was not applicable in that particular year, the AO has to make some kind of an estimate for making the disallowance and hence the logic applied by the AO could not be faulted with. On the issue of recording of satisfaction by the AO before such disallowance, the Ld. DR submitted that the AO's satisfaction can be read by implication.

7. Further, on the issue of recording of satisfaction for the purpose of disallowance u/s 14A, the Ld. DR filed written submissions which are being reproduced as under:

> *Issue of recording of satisfaction in respect of section 14A:*
>
> 1. *"This issue is also dependent on interpretation of the statute and case law of Keshavji Ravji and Co. 183 ITR 1, when there is no ambiguity in statutory language, resorting to interpretative process to unfold the legislative intent becomes impermissible. In my humble submission, since there recording of satisfaction has not been there in words of the relevant provision, it cannot be imported. Legislature, in contrast makes it clear by*

word in Section 148 that recoding is required.

2. *Also, a similar situation exist in section 271 (l)(c) which talks about satisfaction but nor recording. We have several judgments ruling in favour or against recording of satisfaction. However, after ratio of Hon'ble SC in case of Mak Data P. Ltd. 358 ITR 593, the controversy is settled in favour of not recording. As per para 11 of Mak Data P. Ltd. 358 ITR 593, the Hon'ble SC has stated as under:*

> *"11. The Assessing Officer has to satisfy whether the penalty proceedings be initiated or not during the course of the assessment proceedings and the Assessing Officer is not required to record his satisfaction in a particular manner or reduce it into writing...."*

3. *The Calcutta High Court in case of Becker Gray And Company Ltd 2003-TIOL-103-HC-Kol-IT holds a view that while satisfaction of the AO is necessary before issue of a notice, it is not necessary to record such satisfaction in writing in every case*

4. *Recently, the same issue came up for the consideration of the Allahabad High Court in the case of* Shyam Biri Works Pvt. Ltd. v. CIT, *185 CTR 510. The satisfaction of the AO was not recorded in the regular assessment before initiation of the penalty proceedings. While disagreeing with the decision of Hon'ble Delhi HC, Hon'ble Allahabad High Court held that although the AO must have satisfaction as required u/s.273 of the Act, it was not necessary for him to record that satisfaction in writing before initiating penalty proceedings u/s.273 of the Act.*

The Court fortified its view by relying on the decision of the Calcutta High Court in Becker Gray & Co. (1930) Ltd. v. ITO, *112 ITR 503 (Cal) and dismissed the appeal as without merit.*

5. *It is nobody's case that AO is not required to be un-satisfied regarding correctness of expenses claimed by the AO and invoking of rational method of determining the expenses in relation to exempt income. However, the un-satisfaction can be inferred from facts and circumstances of the case. If un-satisfaction has been recorded, it becomes primary basis of showing un-satisfaction. In this case the very fact that assessee claims that no expenditure has been made to earn exempt income, indicates that any person of ordinary intelligence would be un-satisfied about correctness of assesses claims because at least some expenses would be incurred indirectly in process of administration, supervision, stationary and accounting etc. in relation to the investment and dividend there-from (may be nil in a particular year). 7.5 In this situation the ratio of Maxopp Investment Ltd. Vs CIT 201 l-TIOL-753- HC-DEL-IT (laid down by Hon'ble Delhi HC) is applicable which states that before AY 2007-08, the AO has to make a reasonable estimate of the expenditure.*

6. *After Maxopp (supra) (which has binding precedence), all other precedence are not applicable because in the AYs from AY 2007-08 and before, Maxopp makes it mandatory for the AO has to make a reasonable estimate of the expenditure made in respect of the exempt income.*

7. *The onus was upon the assessee to prove that there was no satisfaction of the AO because AO has proceeded to determine the expenditure which indicates non-satisfaction of the AO. Since, it is the assessee who alleges the apparent is not real, therefore, the onus lies on assessee to prove non-satisfaction of the AO was not there. The reliance is placed on the ratio of CIT v. Daulat Ram Rawatmull [1973] 87 ITR 349 (SC).”*

8. ITA No. 2194 - AY 2008-09 : The return of income was filed at Rs. 10,627,057/-, whereas the assessment was framed u/s 143(3) of the Income Tax Act at an income of Rs. 12,427,175/- after making the following additions/disallowances:

i. On account of alleged capital expenses claimed as revenue expenses - Rs. 418,145/-
ii. Disallowance of legal expenses - Rs. 414,000/-
iii. Short term capital gain - Rs. 259,671/-
iv. Interest income - Rs. 27,0704/-
v. Disallowance u/s 14A - Rs. 437,598/-.

8. Aggrieved, the assessee carried the matter before the Ld. CIT (Appeals). On the issue of disallowance of capital expenses wrongly claimed as Revenue expenses, the Ld. CIT (Appeals) held that the impugned amount of Rs. 418,145/- was incurred in connection with the supply and maintenance of liquid hydrogen storage tanks which were to be supplied to Samsung Telecommunication India P. Ltd. The Ld. CIT(Appeals) held that the expenses incurred by the assessee in the construction, laying of foundation and fabrication and erection of structures in form of storage tanks was capital in nature and accordingly the disallowance was upheld. On the issue of disallowance of legal expenses, the Ld. CIT (Appeals) restored an amount of Rs. 27,500/- to the file of AO for verification and confirmed the balance addition. On the issue of addition on account of interest income, it was the contention of the assessee that during the course of survey conducted at the business premises of the assessee on 31/01/2008, an annexure bearing No. A-7 comprising of a chart of alleged settlement between the Assessee Company and Mideast India Ltd. was impounded.

The assessee had given an inter-corporate deposit to Mideast India Ltd. but the latter defaulted in repayment of the loan on the due date resulting in initiation of legal proceedings by the assessee for recovery of the dues. It was the assessee's claim before the Ld. CIT (A) that the chart of settlement was only a proposal and that the settlement had neither materialized nor been adjudicated and, therefore, the action of AO in adding back the interest on accrual basis who was legally not tenable. However, the Ld. CIT(Appeals) held that the accrual of interest income was neither hypothetical nor contingent upon the outcome of the legal proceedings and that the assessee had the right to claim unrealized part of debt as an expense in case the debt becomes bad and his written off as irrecoverable. Accordingly, the action of the AO was held to be correct by the Ld. CIT (A) and the addition was confirmed. On the issue of addition u/s 14A also the assessee's plea was not accepted and the disallowance was upheld.

10. Aggrieved, the assessee has approached this Tribunal and raised the following grounds of appeal:

1(i) That on the facts and circumstances of the case, the CIT(A) was not justified in confirming disallowance of Rs. 4,18.145/- in respect of claim of repair and maintenance by treating the same as capital expenditure.

(ii) That entire claim is for the purpose of business and same is permissible deduction under the law.

2(i) That on the facts and circumstances of the case, the CIT(A) was not justified in confirming disallowance of Rs. 4,14,000/- in respect of claim of legal and professional charges.

(ii) That entire claim is for the purpose of business and there is no case of any disallowance.

3(i).That on the facts and circumstances of the case, the CIT(A) was not justified in confirming disallowance u/s. 14A to the extent of Rs. 4,37,598/- even though there is no finding that any part of claim of expenses is relatable to claim of exempt income on account of dividend from mutual funds.

(ii) That whole basis of disallowance is illegal, arbitrary and without proper consideration of provisions of sec. 14A of the income Tax Act, 1961.

(iii) That even otherwise, the working of disallowance under rule 8D is also not justified.

4(i) That on the facts and circumstances of the case, the CIT(A) was not justified in confirmity addition of Rs.

2,70,704/- as deemed interest even though there is no case of accrual or receipt of any such interest.

(ii) That impugned addition is in total disregard to principle of real income and without proper appreciation of facts of the case.

11. The Ld. AR submitted that as far as the issue of disallowance of repairs and maintenance expenses is concerned, the genuineness of the expenses has not been doubted. He drew our attention to pages 12 and 13 of the PB and submitted that the assessee company had entered into an agreement with Samsung Telecommunication India P. Ltd. on 10/07/2007 for supply and maintenance of Liquid Hydrogen Storage Tanks. It was submitted that the cost of maintenance resulting from the normal wear and tear of the tanks was also to be borne by the assessee company as per clause 1.4 of the agreement. It was submitted that the entire arrangements were part of the Company's business activities and the rental income in respect of the lease of the tanks had been treated by the AO as business income. He also pointed out the copy of the lease agreement filed before the Tribunal and drew attention to page 2 of the said agreement, wherein in clause 1.4 it has been

stated that the maintenance of the capacity will be done by the supplier and the supplier shall bear only the cost of maintenance resulting from normal wear of the capacity and all repairs following damage to part or whole of the capacity cost by the buyer or any third party shall be invoiced by the supplier to the buyer. It was submitted that in view of this clause the expenditure incurred can be rightly inferred to be of Revenue in nature and hence an allowable expense. On the issue of disallowance of legal expenses the Ld. AR drew our attention to pages 12 & 13 of the PB and submitted that the justification of the expenses is as per chart being submitted. On the issue of addition on account of interest income, our attention was drawn to page 33 of the PB which contains the copy of the chart of alleged settlement with Mideast Pvt. Ltd. and it was submitted that the alleged settlement note does not have any signature of either of the parties and hence its veracity as an evidence cannot be relied upon by the Department. The Ld. AR also drew our attention to page 38 of the PB which contains a date wise list of events concerned with the petition/criminal

complaint u/s 138 of the Negotiable Instruments Act filed by the assessee against Midesat Pvt. Ltd. It was also submitted that the assessee has not shown interest income since 1997 as the realisability of interest was not certain and the Department has also not disputed the same in earlier years. Our attention was also drawn to page 37 of the PB which is an order of settlement dated 24/01/2013 passed by the Hon'ble Judicial Magistrate/ACJ (JD.), Ghaziabad. Our attention was also drawn to page 55 & 60 of the PB, wherein the interest income of Rs. 804,620/- has been duly shown under other income in subsequent assessment year. Relying on the decision of the Hon'ble Apex Court in the case of CIT vs. Excel Industries, 358 ITR 295 (SC), it was submitted that since the amount due as interest has already been included under 'income' subsequent to the settlement, the addition ought to be deleted. On the issue of 14A disallowance it was submitted that there was no exempt income during the year under consideration and our attention was drawn to page 3 of the PB containing the profit and loss account of the year in support of the claim.

12. In response, the Ld. DR submitted that as far as the disallowance of repairs and maintenance expenses on account of them being capital in nature is concerned, no evidence was filed before either the Ld. CIT(Appeals) or the AO by the assessee in support of its claim and hence the impugned action cannot be wronged with. It was submitted that the perusal of the bills on record will justify the AO's stand. On the issue of legal expenses it was again the submission of the Ld. DR that no evidences had been filed by the assessee in support of its claim and that the nexus between the payments made and the benefit to the assessee's business could not be brought out by the assessee. On the issue of addition of interest it was submitted that any document found during the course of survey has to be disproved by the assessee because in survey proceedings the presumption is against the assessee who has to make the rebuttal through concrete material and not through a simple statement. It was further submitted that the settlement order being relied upon by the assessee was neither produced before the AO nor before the CIT and hence they had no

occasion to consider the same. On the issue of disallowance u/s 14A, the Ld. DR's submissions were the same as in AY 2008-09 and the same have not been reproduced for the sake of brevity.

13. ITA No. 2193 - AY 2009-10: The assessee had filed return of income at Rs. 82,133,210/-, whereas the assessment u/s 143(3) was completed at an income of Rs. 84,031,070/- after making the following additions:

1. Addition on account of interest income - Rs. 809,731/-
2. Addition on account of disallowance u/s 14A - Rs. 1,088,129/-

14. The facts on which these impugned additions were made are similar to that of AY 2008-09 which have been mentioned in the earlier part of this order and the Ld. CIT (Appeals) has dismissed these grounds of the assessee on a similar reasoning as adopted in AY 2008-09.

15. Aggrieved, the assessee has preferred an appeal before the Tribunal and has raised the following grounds of appeal:

1(i) *That on the facts and circumstances of the case, the CIT(A) was not justified in confirming disallowance u/s 14A to the extent of Rs. 10,88,129/- even though there is no finding that any part of claim of expenses is relatable to claim of exempt income on account of dividend from mutual funds.*

(ii) *That whole basis of disallowance is illegal, arbitrary and without proper consideration of provisions of sec. 14A of the income Tax Act, 1961.*

(iii) That even otherwise, the working of disallowance under rule 8D is also not justified.

2(i) That on the facts and circumstances of the case, the CIT(A) was not justified in confirmity addition of Rs. 8,09,731/- as deemed interest even though there is no case of accrual or receipt of any such interest.

(ii) That impugned addition is in total disregard to principle of real income, and without proper appreciation of facts of the case.

16. On the issue of interest, the Ld. AR made similar submissions as in AY 2008-09 which are not being reproduced for the sake of brevity. On the issue of 14A disallowance, it was

submitted that in this year there was no dividend income which was evident from page 3 of the PB which is the audited profit and loss account for the year under consideration.

17. The Ld. DR also advanced the same arguments as in AY 2008-09 and AY 2007-08 which are not been reproduced for the sake of brevity. It was also urged by the Ld. DR that even though the exempt income might not have been earned, but expenses would have been incurred any way and hence, disallowance u/s 14A cannot be ruled out.

18. We have heard the rival submissions and perused the relevant records. It is seen that disallowance of legal/ professional expenses is common to assessment years 2007-08 & 2008-09, whereas the addition on account of interest is identical in AY 2008-09 and AY 2009-10. The issue of disallowance u/s 14A is common and all the three years under appeal. The issue of *adhoc* disallowance of 20% on sales promotion expenses is relevant for AY 2007-08. The issue of

disallowance out of repairs and maintenance expenses and the treatment of the same as capital expenditure is relevant to AY 2008-09.

19. We now take up these disallowances one by one:

(i) Disallowance of Rs. 5,390,821/- in AY 2007-08 and Rs. 414,000/- in AY 2008-09 from Legal/Professional Expenses –

It is the claim of the assessee that the genuineness of the expenses has not been disputed at all and since audited accounts had been submitted *adhoc* disallowance is not justified. A perusal of the assessment order for AY 2007-08 shows that the assessee had claimed an amount of Rs. 26,954,106/- on account of legal and professional charges and the AO has given a finding that the assessee was asked to file details and nature of these expenses in response to which the assessee had filed some copies of bills/vouchers. Thereafter, the AO proceeded to disallow a sum of Rs. 5,390,821/- being 20% on these expenses on account of

absence of any proper justification of these expenses. The Ld. CIT (Appeals) also upheld the disallowance on the reasoning that out of the total legal and professional expenses, the purpose for which services were received was satisfied only in some cases and no details relating to the nature of services were filed to an extent of Rs. 5,391,919/- In AY 2008-09, the AO has disallowed seven bills amounting to Rs. 414,000/- by specifically pointing out seven bills as inadmissible and no *adhoc* disallowance has been made. The Ld. CIT (Appeals) upheld the addition made by the AO on the same reasoning as adopted by the AO except that he accepted the assessee's contention in respect of two bills which were restored to the file of the AO for allowance after verification. Having gone through the records and heard the rival submissions we are of the considered opinion that as far as *adhoc* disallowance of Rs. 5,390,821/- in AY 2007-08 is concerned, the disallowance has been made on the ground that the required details have not been provided by the assessee. Although it is the

Department's contention that the assessee has not provided all the details and bills, it is not the department's case that the assessee was asked to produce all the bills in which it has failed to do so. It is seen from the perusal of records that the basis of disallowance has not been explained and an *ad hoc* disallowance has been made. The assessee has submitted that a detailed chart of the expenses incurred under the head "Legal and Professional Charges" and it is not the Department's case that the expenses incurred are not genuine. A perusal of the assessment order also shows that this issue has been dealt in a very cryptic manner without any factual finding by the AO and the Ld. CIT (Appeals) has also simply upheld the disallowance. It is the Department's allegation that no details relevant to nature of services were filed. However, the records show that no such details were ever called for from the assessee. Hence, we are unable to uphold the disallowance and we set aside the order of the Ld. CIT (Appeals) on this issue and direct the AO to delete the

addition of Rs. 5,390,821/- disallowed on account of legal and professional services for AY 2007-08. For AY 2008-09, a perusal of the assessment order shows that the AO has disallowed seven bills amounting to Rs. 4,14,000/- wherein one bill of Rs. 20,000/- paid to M/s Ramji Lal Kudan Lal Jewellers paid for the valuation of jewellery held by various members of the family of the Director of the assessee and a bill of Rs. 7,500/- paid to Shri Sanjay Bajaj for vetting the security documents in the matter of Mrs. Meera Goel can be said to be not related to the business of the assessee. These two disallowances have already been restored to the file of the AO by the Ld. CIT (Appeals) for verification. In respect of the remaining disallowance, in some cases, it has been contended by the assessee that since the bills had been raised in a wrong name, the disallowance was made, whereas in some other instances the AO has made the disallowance on the ground that the same pertained to a prior period whereas the fact is that these bills had to be accounted for on payment basis. Hence, in the interest of

justice, we restore the balance disallowance of Rs. 3,86,500/- on account of legal/professional fee also to the file of the AO for a fresh verification and examination after giving the assessee a due opportunity of being heard.

(ii) Addition on account of interest accrual of Rs. 270,704/- in AY 2008-09 & Rs. 809,731/- in AY 2009-10 –

It is the assessee's contention that subsequent to the settlement reached with M/s Mideast Pvt. Ltd., the assessee has duly shown the interest income in subsequent years. The assesse has also brought on record the order dated 24/01/2013 of the Hon'ble Judicial Magistrate/ACJ (JD), Ghaziabad and which has been placed at pages 36 & 37 of the PB pertaining to AY 2008-09. We also concur with the assessee's reliance on CIT vs. Excel Industries, 358 ITR 295 (SC), wherein the Hon'ble Apex Court has opined that it is well settled that *"Income Tax cannot be levied on hypothetical income and that income accrues when it becomes due. But it must also be*

accompanied by a responding liability of the other party to pay the amount and only then can it be said that for the purposes of taxability that the income is not hypothetical and it has really accrued to the assessee." It is our considered opinion that the income accrued to the assessee only at the stage when the settlement was finally reached with the M/s Mideast India P. Ltd. The assessee has not been declaring income on accrual basis since 1997 as the party had defaulted in repayment and ultimately the matter had to be settled through the Civil Court. It is also not the Department's case that this interest has no where been included in the taxable income of the assessee. Therefore, we are inclined to agree with the contention of the assessee that since this income has been included in the taxable income in subsequent years the addition ought to be deleted in assessment years 2008-09 & 2009-10. While allowing these grounds of appeal, we remit the issue to the file of the AO to verify the assessee's claim that such interest income has been included in the computation of

taxable income by the assessee in subsequent years and if it be so the AO is directed to delete these additions in both assessment years 2008-09 & 2009-10.

(iii) Disallowance u/s 14A - Rs. 28,995,395/- for AY 2007-08, Rs. 437,598/- for AY 2008-09 and Rs. 1,088,129/- for AY 2009-10 –

In AY 2007-08, it is seen that the AO has made a proportionate disallowance of interest u/s 14A. A perusal of the Balance Sheet as on 31/03/2007 shows that the total capital and reserves stood at Rs. 2,521,437,467/- as against total investment of Rs. 45,45,300/-. It is further seen that investments have reduced from Rs. 7.66 crores at the beginning of the year to Rs. 0.45 crores at the close of the year and hence no new investments can be said to have been made. Moreover, the Department has not established any nexus between the investments and borrowed funds. It is seen that this issue is squarely covered by a judgment

Of The Hon'ble Bombay High Court in the case of Commissioner of Income Tax v/s Reliance Utilities and Power Ltd., reported in (2009) 313 ITR 340 (Bom). The facts of that case were that the assessee viz. M/s Reliance Utilities and Power Ltd. had invested certain amounts in Reliance Gas Ltd. and Reliance Strategic Investments Ltd. It was the case of the assessee that they themselves were in the business of generation of power and they had earned regular business income there from. The investments made by the assessee in M/s Reliance Gas Ltd. and M/s Reliance Strategic Investments Ltd. were done out of their own funds and were in the regular course of business and therefore no part of the interest could be disallowed. It was also pointed out that the assessee had borrowed Rs.43.62 crores by way of issue of debentures and the said amount was utilised as capital expenditure and inter-corporate deposit. It was the assessee's submission that no part of the interest bearing funds (viz. Issue of

debentures) had gone into making investments in the said two companies. It was pointed out that the income from the operations of the Assessee was Rs.313.53 crores and with the availability of other interest free funds with the assessee the amount available for investments out of its own funds were to the tune of Rs.398.19 crores. In view thereof, it was submitted that from the analysis of the balance-sheet, the assessee had enough interest free funds at its disposal for making the investments. The CIT (Appeals) on examining the said material, agreed with the contention of the assessee and accordingly deleted the addition made by the Assessing Officer and directed him to allow the same under the provisions of the Income Tax Act, 1961. The Revenue being aggrieved by the order preferred an Appeal before the ITAT who upheld the order of the CIT (Appeals) and dismissed the Appeal of the Revenue. From the order of the ITAT, the Revenue approached the Hon'ble High Court by way of an Appeal. After examining the entire

factual matrix of the matter and the law on the subject, the Hon'ble High Court held as under:-

> *"If there be interest-free funds available to an assessee sufficient to meet its investments and at the same time the assessee had raised a loan it can be presumed that the investments were from the interest-free funds available. In our opinion, the Supreme Court in East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627 had the occasion to consider the decision of the Calcutta High Court in Woolcombers of India Ltd. (1982) 134 ITR 219 where a similar issue had arisen. Before the Supreme Court it was argued that it should have been presumed that in essence and true character the taxes were paid out of the profits of the relevant year and not out of the overdraft account for the running of the business and in these circumstances the appellant was entitled to claim the deductions. The Supreme Court noted that the argument had considerable*

force, but considering the fact that the contention had not been advanced earlier it did not require to be answered. It then noted that in Woolcombers of India Ltd.'s case (1982) 134 ITR 219 the Calcutta High Court had come to the conclusion that the profits were sufficient to meet the advance tax liability and the profits were deposited in the over draft account of the assessee and in such a case it should be presumed that the taxes were paid out of the profits of the year and not out of the overdraft account for the running of the business. It noted that to raise the presumption, there was sufficient material and the assessee had urged the contention before the High Court. The principle, therefore, would be that if there were funds available both interest-free and over draft and/or loans taken, then a presumption would arise that investments would be out of the interest-free funds generated or available with the company if the interest-free funds were sufficient to meet the

investment. In this case this presumption is established considering the finding of fact both by the Commissioner of Income-tax (Appeals) and the Income-tax Appellate Tribunal."

Hence, on the facts of the case and respectfully following the ratio laid down by the Hon'ble Bombay High Court in the case of Reliance Utilities (supra) we set aside the order of the Ld. CIT (A) on this issue for AY 07-08 and direct the AO to delete the disallowance of Rs. 28,995,395/- made u/s 14A.

Further, in AY 08-09 the asseseee is stated to have earned dividend income of Rs. 2,59,671/- only whereas the AO has made a disallowance of Rs. 4,37,598/- u/s 14A . The assessee had incurred finance charges/interest amounting to Rs. 10,32,38,840/- during the year and the investment had risen from Rs. 45,45,300/- on 31-03-2007 to Rs. 2,04,07,800/- as on 31-03-2008. It was the assessee's contention that no expenditure was incurred to earn the

dividend income and that the income earned during the year related to old investments but the AO held that no details were filed by the assessee in support of this claim. The Ld. CIT (A) also upheld the disallowance on this ground only.

In AY 2009-10, the assessee is stated to not have earned any dividend income but the assessment order mentions that the assessee has provided a working of disallowance u/s 14A read with rule 8D, in which the disallowance has been calculated at Rs. 10,38,087/-. However, the AO has stated that he accepts the working of the disallowance as submitted by the assessee but has made a disallowance of Rs. 10,88,129/- without providing any working. In appeal, the assessee contested the addition on the ground that no expenses were attributable to the exempt income. The Ld. CIT (A) upheld the disallowance on the ground that the assessee did not provide any details before the AO regarding its claim that no expenditure was incurred and also relied on the fact that disallowance u/s 14A had been made in the case of the assessee in earlier assessment years also. Thus we find that

there is a contradiction in the factual matrix as stated by the assessee and as stated by the department.

The scheme of section 14A has within it implicit notion of apportionment in the cases where the expenditure is incurred for the composite/indivisible activities in which taxable and non-taxable income is received. But when it is possible to determine the actual expenditure in relation to the exempt income or when no expenditure has been incurred in relation to the exempt income, then principle of apportionment embedded in section 14 A has no application. The objective of section 14 A is not allowing to reduce tax payable on the normal exempt income by debiting the expenditure incurred to earn the exempt income. Thus, the expenses incurred to earn exempt income cannot be allowed and the expenses shall be allowed only to the extent they are related to the earning of taxable income. If there is expenditure directly or indirectly incurred in relation to exempt income, the same cannot be claimed against the income, which is taxable as it is held by

the Hon'ble Supreme Court in case of Commissioner of Income-tax v. Walfort Share and Stock Brokers P. Ltd. reported in 326 ITR 1 (SC) that for attracting the provisions of section 14 A, there should be proximate cause for disallowance which as relationship with the tax exempt income. The expenditure incurred in relation to the income which does not form part of total income has to be disallowed. However, it should be proximate relationship between the expenditure and the income, which does not form part of total income. Once such proximity relationships exist, the disallowance is to be effected. In case the assessee had claimed that no expenditure has been incurred for earning the exempt income, it is for the assessing officer to determine as to whether the assessee had incurred any expenditure in relation to income which did not form part of total income and if so, to quantify the extent of disallowance. Thus, in order to disallow the expenditure under section 14A, there must be a live nexus between the expenditure incurred and the income not forming part of total income. No notional expenditure can

be apportioned for the purpose of earning exempt income unless there is an actual expenditure in relation to earning the income not forming part of total income. If the expenditure is incurred with a view to earn taxable income and there is apparent dominant and immediate connection between the expenditure incurred and taxable income, then no disallowance can be made under section 14A merely because some tax exempt income is received by the assessee.

On going through the records and hearing the rival submissions for AY 2008-09 and 2009-10 on this issue, it is seen that the assessee has been claiming that no expenditure has been incurred in relation to earning of exempt income. However, the department's stand is that no details were filed. Further, the Assessing Officer has presumed that the assessee must have incurred some expenditure for earning the exempt income. The Assessing Officer has adopted the formula for estimating expenditure on the basis of investments but the justification for calculating the

disallowance is missing. The Hon'ble Delhi High Court in the case of Maxopp Investment Ltd. vs CIT (I.T.A. 687/2009) has opined in para 29 of the order as under:-

> *"29. 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."

Similarly, the Hon'ble High Court of Punjab & Haryana in the case of CIT-II vs Hero Cycles Ltd. in I.T.A. No. 331 of 2009 (O&M) has held in para 4 of the judgment that, *"the contention of the Revenue that directly or indirectly some*

expenditure is always incurred which must be disallowed u/s 14A and the impact of expenditure so incurred cannot be allowed to be set off against the business income which may nullify the mandate of section 14A, cannot be accepted. Disallowance u/s 14A requires finding of incurring of expenditure. Where it is found that for earning exempted income, no expenditure has been incurred disallowance u/s 14A cannot stand."

Mumbai 'J' Bench of the ITAT has held in the case of Justice Sam P. Bharucha vs ACIT in I.T.A. No. 3889/Mum/2011 that no disallowance u/s 14A of the Act is called for when the assessee has not incurred and claimed any expenditure for earning the exempt income.

Therefore, on an overall consideration of the facts of the case and respectfully following the ratio of the judgments as aforementioned, we hold that the disallowance u/s 14A was made without due deliberation and analysis by the Assessing Officer and the Ld. CIT(A) was also patently wrong in confirming the disallowance without testing the

sustainability of the disallowance. Hence, we set aside the findings of the Ld. CIT (A) on this issue for AY 2008-09 as well as 2009-10 and restore the matter to the file of the AO for both the assessment years for fresh adjudication after due verification of the claim of the assessee regarding no expenditure having been incurred to earn exempt income as well as not having earned any exempt income/dividend income as the case might be during AY 2008-09 and 2009-10. Needless to say, the AO shall afford a proper opportunity to the assessee to present its case.

(iv)Sales Promotion Expenses - A sum of Rs. 817,094/- has been disallowed in AY 2007-08 being 20% of the total expenses on sales promotion disallowed on *adhoc* basis. The AO has mentioned in his order that the assessee had paid Rs. 4,085,469/- as sales promotion expenses and the assessee was asked to file party wise details along with the nature of expenses but no details have been filed in this regard. Accordingly, in absence of any confirmation, an

amount of Rs. 817,094/- was disallowed. The Ld. CIT (Appeals) confirmed the disallowance relying on the AO's order that since party wise details along with nature of expenses were never filed before him, the disallowance was to be upheld. In the PB for AY 2007-08 at page 11 the assessee has provided a chart giving a breakup of sales promotion expenses and the breakup as provided in the chart is as under:

i. Gift to customers Rs. 945,200/-;
ii. Festival expense Rs. 1,343,725/-;
iii. Expenses on business Rs. 718,330/-;
iv. Incentive to customers Rs. 245,420/-;
v. Magazine subscription fees Rs. 50,450/-;
vi. Discount and rebate Rs. 782,344/-

Thus, a break-up of the sales promotion expenses has been filed. However, the relevant details/vouchers have not been placed on record at this juncture also. It is also a matter of record that the Ld. CIT (Appeals) also did not call for any record from the assessee for the verification of

expenses on this account and simply held that since the details were not filed before the AO, no specific defect could have been pointed out by the AO and further upheld the disallowance. Hence in the interest of justice we restore the issue to the file of the AO for fresh adjudication on the issue of sales promotion expenses after giving the assessee a due opportunity of producing its relevant records.

(v) Repairs & Maintenance - The disallowance of Rs. 418,145/- has been made in AY 2008-09 as being of capital in nature. The Ld. CIT (Appeals) was of the view that the expenses incurred by the assessee in construction, laying foundation and erection of the storage tank was necessarily towards bringing a new asset into existence and hence it was capital in nature. We have perused the relevant clauses of the agreement entered into by the assessee with M/s Samsung Telecommunication India P. Ltd., wherein it has been specifically provided that the cost of maintenance resulting from the normal wear and tear of the tank was to be borne by the assessee. The assessee

has produced the copies of bills connected with the said expenditure at pages 15 to 20 of the PB for AY 2008-09. The bill placed at page no. 15 of the PB pertaining to an amount of Rs. 220,145/- made to Maa Gyatri Construction essentially pertains to construction work/concrete filling. Similarly bills placed at pages 17 & 18 of the PB are of G.K. Fabricator & Rolling Shutter and pertains to Jali Gate, Pipes and welding and fitting. Similarly Rs. 7,000/- have been paid in cash for laying the foundation work and Rs. 41,000/- have been paid to Mr. T.P. Sharma for fabrication and erection work. It is very much evident that these expenses pertain to erection and commissioning of storage tanks rather than repairs and maintenance expenses as claimed by the assessee. Hence, we find no reason to interfere with the findings of the lower authorities on this issue and confirm this addition.

20. In the final result, ITA No. 2192 for AY 2007-08 is allowed, ITA No. 2194 for AY 2008-09 is partly allowed and ITA No. 2193 for AY 2009-10 is allowed.

Order is pronounced in the open court on 30.06.2016

Sd/-	Sd/-
(PRASHANT MAHARISHI)	**(SUDHANSHU SRIVASTAVA)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Dated: 30/06/2016
**Kavita Arora*

Copy forwarded to:
1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR
ITAT NEW DELHI