

IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCH 'C', BANGALORE

BEFORE SHRI. ABRAHAM P. GEORGE, ACCOUNTANT MEMBER

AND

SHRI. VIJAYPAL RAO, JUDICIAL MEMBER

I.T.A No.309/Bang/2013
(Assessment Year : 2009-10)

M/s. Hindustan Aeronautics Ltd,
No.15/1, Cubbon Road,
Bangalore 560 001
PAN : AAACH3641R

.. Appellant

v.

Addl. Commissioner of Income-tax,
Range - 11, Bangalore

.. Respondent

Assessee by : Shri. Praveen Kumar Prasad, ITP
Revenue by : Shri. Sanjay Kumar, CIT -III

Heard on : 17.03.2016
Pronounced on : 22.04.2016

ORDER

PER ABRAHAM P. GEORGE, ACCOUNTANT MEMBER :

In this appeal filed by the assessee against an order dt.24.12.2012 of CIT (A)-I, Bengaluru, it has altogether raised six grounds of which grounds 1 and 6 are general and ground 5 is consequential in nature needing no specific adjudication.

02. Grounds 2 and 3 are reproduced hereunder :

2. That on the facts in the circumstances of the case, the Ld. CIT(A) erred in upholding the disallowance of expenditure incurred by the Appellant on Research & Development amounting to Rs. 5,706,155,000.
- 3(a). That without prejudice to ground No. 2 above and on the facts and in the circumstances of the case, the Ld. CIT(A) erred in not admitting the additional ground filed by the Appellant in respect of deduction of expenditure under section 35(1)(iv) of the Act.
- 3(b). That the Ld. CIT(A) erred in not following the settled principles on admission of additional grounds laid down by the Hon'ble Supreme Court in **Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688 (SC)** and **National Thermal Power Co. Ltd. vs. CIT (1998) 229 ITR 383(SC)**.
- 3(c). That on the facts and in the circumstances of the case and without prejudice to the grounds taken above, the Ld. CIT(A) erred in not allowing deduction of the impugned expenditure under section 35(1)(iv) of the Act.

03. Facts relating to the above grounds are that assessee a public sector undertaking involved in designing, developing, manufacturing and doing works related to repair and overhaul of aircrafts, helicopter engines, avionic systems etc., had filed its return for the impugned assessment year declaring income of Rs.1238,61,15,646/-.

04. During the course of assessment proceedings it was noted by the AO that while computing the total income assessee had through its computation statement deducted a sum of Rs.570,61,55,000/-, which was credited in its P & L account under the head "Grants received from Government for R & D". Assessee was required to explain why corresponding expenditure incurred for the R & D was not added back. Explanation of the assessee was that the grants received from the Government were for the R & D activities. As per the assessee, expenditure incurred against such grants were revenue in nature and there was no necessity to reduce it from total

expenditure. Break-up of such expenditure given by the assessee read as under

Rs. In Lakhs

DIVISION	LABOUR COST	MATERIAL COST	SUNDERY DIRECT CHARGES	TOTAL
LCA	4,454.71	11,338.57	595.19	16,388.47
ARDC	12,756.84	4,537.54	8,753.65	26,048.03
LUCKNOW	1,158.67	447.49		1,606.16
KORWA	90.08			90.08
RWRDC	3,719.29	5,743.74	2,257.56	11,720.59
SLRDC-HYDERABAD	713.24	494.99		1,208.23
TOTAL	22892.83	22562.33	11606.4	57061.56

Light combat aircrafts ('LCA' in short) related to development of Combat aircrafts, ARDC expenditure at Lucknow related to accessories, KORWA, RWRDC and SLRDC related to Hyderabad division.

05. AO put the assessee on notice to explain as to why expenditure relating to R & D grants should not be considered as capital outgo and disallowed. Explanation of the assessee could be summarised as under :

i) Funds received from the Government as grants was for conducting defence related research ultimately helping the assessee to acquire capital asset in the form of indigenous and self-reliant technology for the manufacture of LCA, Intermediate Jet Trainer (IJT), Sea Harrier, Weapon System Integration (WSI), Light Utility Helicopter (LUH) and Light Combat Helicopter (LCH).

ii) Expenditure incurred was to achieve self-reliance in manufacture of aerospace equipment.

iii) Due to the infrastructure assessee had for R & D, it could develop products like ALH, IJT and LCA.

iv) Assessee had partnership with DRDO and CSIR Labs, IITs and sister DSPUs for defence research. Assessee was developing basic platform in areas like sensors, actuators, advanced radar electro optics, intelligent autonomous systems and network enabled capabilities.

v) LCA development programme for developing a multi utility aircrafts with fully integrated aviation system was being managed by aeronautical development agency of Defence Research & Development organisation with assessee as a major partner.

06. In sum and substance, contention of the assessee was that its expenditure relatable to the grant received was incurred for design and development of weaponry for aircraft, combat aircrafts, avionics for combat aircrafts, development of light utility helicopter and for developing a fifth generation fighter aircraft to replace the aging jaguar and MIG 29. Assessee also pointed out that a coordinate bench of this Tribunal had held such grants from the Government to be capital receipt for A. Ys. 1994-95 to 1997-98. As per the assessee, expenditure incurred using such grant made it possible to design and develop new fighter aircraft and helicopters which were of vital importance to the security of the country.

07. AO agreed with the contention of the assessee that receipts of grant were capital in nature. However according to him, matching principles required expenditure which were relatable to such grant to be excluded

from the total expenditure debited in the P & L account. As per the AO expenditure incurred out of capital receipts for specific R & D could be treated only as capital expenditure. AO also noted that assessee in its letter dt.14.11.2011 itself claimed the expenditure to be of capital in nature. As per the AO assessee itself had admitted that the expenditure incurred were for development of LCA and LC helicopter, intermediate jet trainer and development of new technology for avionics and instrumentation. AO noted that expenditure incurred by the assessee for development of new combat aircrafts, helicopter and fighters ought to have been shown as work-in-progress till such time it could become marketable commodity. Relying on the decision of Hon'ble Apex Court in M/s. J. K. Industries Ltd and Another v. Union of India [297 ITR 176], AO was of the opinion that Rs.570,61,55,000/- being the grant received from the Government should be reduced from expenditure also. Such reduction resulted in an addition of the same sum to the total income returned by the assessee.

08. Aggrieved assessee moved in appeal before the CIT (A). Apart from reiterating the contentions taken before the AO, assessee made the following further submissions before the CIT (A) :

i) Capital receipts by itself did not mean that expenditure incurred therefrom was capital expenditure.

ii) Expenditure incurred against grant of Rs.570,61,55,000/- was for the purpose of recreating existing technology and developing

new technology. Even if the expenditure was considered as capital in nature by virtue of Section 35(1)(iv) of the Act, it was allowable.

iii) Expenditure incurred by the assessee was only for scientific research within the meaning of Section 35(1)(iv) read along with Section 43(4) of the Act.

09. CIT (A) sought a remand report from the AO. AO made the following remarks in his remand report :

(i) Nature of a receipt or expenditure therefrom would not change at the whims and fancies of the assessee.

(ii) Grant received by the assessee from the Government was only for meeting expenditure which was in the nature of capital outlay.

(iii) Assessee itself had explained that the grants were received for R & D relating to new aircrafts, technology and avionics.

(iv) Grants received by the assessee from the government were part of allocations for defence in the union budget and letters of grant clearly spelt out the purpose of such grant as development of various defence and aeronautical prototypes.

(v) Though the nature of certain classes of expenditure like material purchase and sundry expenditure in relation to development of prototypes was prima facie revenue in nature, considering the ultimate result which was the creation of a capital asset in the form of new prototype design, it was required to be capitalised.

(vi) Assessee had taken out the grants while computing its total income the corresponding capital outgo was not reduced from the expenditure.

10. CIT (A) after considering the submissions of the assessee and the remand report of the AO was of the opinion that funds received by the assessee from the government as grants were for acquiring advanced

technical knowhow for manufacture of advanced combat aircraft equipments. As per the Ld. CIT (A), grants given by GOI were appropriated out of the capital budget of Ministry of Defence. CIT (A) held that action of the assessee of excluding only the capital receipt from the net profit without corresponding reduction of expenditure resulted in under-statement of profits. Further according to him expenditure incurred by the assessee resulted in creation of new capital assets in the form of prototypes and designs. He rejected the contention of the assessee that the expenditure incurred was for recreating the existing technology.

11. As for the claim of assessee that deduction of such expenditure was to be given under Section 35(1)(iv) of the Act, which was raised as an additional ground, CIT (A) relying on the judgment of Hon'ble jurisdictional High Court in the case of CIT v. BAEHAL Software Ltd, in ITA No.136 of 2010, Dt.01.03.2011, which incidentally was a sister concern of the assessee, held that without filing a revised return, such a claim could not be admitted. As per the CIT (A) assessee had never claimed such a deduction either in the return of income or during the pendency of the proceedings before the AO. Though the CIT (A) did not admit the additional ground, he gave a finding that such ground itself reflected assessee's predicament regarding the nature of expenditure. According to the CIT (A), if it was sure that expenditure was scientific in

nature, it ought have claimed a deduction u/s.35(1)(iv) of the Act, in the return of income , or at least through a revised return. Further according to him, Section 35(1)(iv) and Section 43(4) of the Act used the term 'scientific research' and not R & D. As per the CIT (A) claim of the assessee was under the head R & D and not under scientific research. Thus he did not accept the alternate claim of the assessee for deduction u/s.35(1)(iv) of the Act.

12. Now before us, Ld. AR strongly assailing the orders of the authorities below submitted that assessee had reduced the grants amount of Rs.570,61,55,000/- from its total income through the computation statement, since it was a capital receipt. However this, according to him it would not mean that expenditure made out of the grant was also capital outgo. As per the Ld. AR, assessee had incurred expenditure of about Rs.67,478.11 lakhs for R & D. This included raw materials, expenditure on salaries and other expenditure like depreciation, provisions etc., According to him, a break-up of the said expenditure, placed at paper book page 145, clearly proved that these were revenue in nature and did not result in acquisition of any capital asset. Further according to him, the question of matching principle did not arise in the given case. Just because expenditure was incurred for R & D, a presumption could not be taken that it resulted in acquisition of any capital asset. In any case according to him, if it was

treated as a capital outgo, lower authorities ought to have given eligible deduction u/s.35(1)(iv) of the Act. Assessee had no chance for raising such a claim before the AO since it had claimed the whole of the expenditure as revenue in nature. When a disallowance of the expenditure was made, assessee had preferred such a claim before the CIT (A). As per the Ld. AR, CIT (A) refused to entertain the claim, relying on a judgment of Hon'ble jurisdictional High Court in the case of M/s.BEAHAL Software Ltd, (supra), which was on a different set of facts.

13. Per contra, Ld. DR submitted that assessee having admitted to have incurred expenditure against the grant, for development of prototypes of new aircrafts and new technologies, which were yet to be commercialized, ought to have shown it as work-in-progress and ought not have charged it to the P & L account. Having not done so, that as per the Ld. DR, lower authorities were justified in disallowing the relatable expenditure.

14. In so far as the alternate pleading of the assessee that it had to have been allowed deduction under Section 35(1)(iv) of the Act, Ld. DR submitted that there was no way the AO could have allowed it, without a claim from the assessee. Relying on the judgment of Hon'ble Apex Court in the case of Goetze (India) Ltd v. CIT [284 ITR 323], Ld. DR submitted that a fresh claim could not have been made otherwise than

through a revised return, which assessee had not done.

15. We have perused the orders and heard the rival contentions. There is no dispute that assessee had received a sum of Rs.570,65,61,000/- as grant from the central government. It had deducted the said sum while computing its total income for the tax purposes. In other words, assessee itself had treated it as capital receipts. We find that such treatment given by the assessee is in accordance with a decision given by this Tribunal in assessee's own case for A Y. 1995-96 in ITA No.763/Bang/1998, dt.22.02.2002, placed at paper book page nos.207 to 230. In the said decision a reference has been made to the Memorandum of Understanding between the assessee and Aeronautical Development Agency of Government of India. It seems in the said Memorandum of Understanding, one of the conditions agreed by the assessee was that there would be no charge of depreciation on capital assets funded by the government. Relevant observations of the Tribunal at para 23 & 24 is reproduced hereunder :

“23. Neither party has put before us the memorandum of undertaking between the assessee and Government agency releasing the grants. Hence it is difficult for us to give any finding on the basis of its reference in order u/s.263 for assessment year 1994-95. The same has not been discussed by the authorities below. However, the condition regarding no claim of

depreciation by assessee supports its contention as to the capital nature of the grant. It can be safely concluded that though the assessee by receiving such a grants develops a technology or design for manufacture, which will be a capital asset, yet, it will not be eligible to claim depreciation. The assessee is not in business of selling technologies. The Government retained the services of the assessee to develop the technology to be used subsequently, in manufacture of vital defence equipments. Mere calculation of payment based on man hour basis does not imply that it is reimbursement of expenses. The base for giving grant does not change the very character of receipts. To this extent, the arguments advanced by the revenue is not convincing so as to treat the nature of grant as revenue receipts.

24. We therefore, hold that the grants received by the assessee though credited to P & L account is capital receipt and hence not income u/s.5 chargeable to tax. This ground is therefore, allowed.”

15. A clear observation has been made by the Tribunal that by utilising the grants, assessee was developing technologies or design for manufacture which would be a capital asset. This was the reason why Tribunal accepted the claim of the assessee that grants received were capital in nature.

16. In assessment proceedings for A. Y. 2003-04 also there was an issue regarding nature of the grant received from the Central Government. Assessee had during the course of hearing for said year addressed a letter to the ACIT, dt.29.12.2005, giving a background of its claim regarding the grant. Copy of this has been placed at paper book pages 231 to 258.

Relevant paras appearing therein is reproduced hereunder :

4.1.1 The next issue before Assessing Officer is treating the Grants received from Government for the conduct of defence related research as a trading receipt and taxing the same.

4.1.2 HAL is a Public Sector Company wholly owned by the Government of India under the Ministry of Defence engaged in the business of manufacture and maintenance of aircraft , helicopters , avionic systems etc. As part of its National Defence Strategy, the Government of India had identified amongst others, the need for acquiring indigenous capabilities in the design & development for the subsequent manufacture of:

- a) State-of-Art, Armed & Multi-Role Helicopters, capable of functioning at high altitudes and in harsh terrains, that are the indispensable requirement of the Defence forces like the IAF, Army, Navy , the Coast Guard etc; and
- b) Multi-role, light weight combat aircraft with contemporary capabilities which would meet the near – future requirements of the Defence forces like the IAF, Army, Navy , the Coast Guard etc;

4.1.3 HAL was identified to undertake the above research and development programs mainly in respect of the Advanced Light Helicopter (ALH) and the Light Combat Aircraft (LCA) for acquiring the necessary technological capabilities for the subsequent production activities by HAL.

4.1.4 Accordingly, HAL is involved in the design & development of:

- a) The ALH is a 5.5 tonne twin turbine helicopter with multi role, multi-mission capabilities for use in wide range of military applications. ALH is designed to meet the most challenging and the stringent requirements of the armed forces. It is optimized for the under mentioned missions:

Armed Roles:

- Anti Tank
- Close Air Support
- Anti Submarine warfare
- Anti surface vessel warfare

Unarmed Roles:

- Heliborne assault
- Logistic support
- Air observation post
- Reconnaissance
- Casualty evacuation

- b) The LCA is the smallest lightweight multirole supersonic aircraft in the world with agility, maneuverability, all weather, day / night capability which uses advanced aerodynamic structural, avionics and control system design methodologies with the following state-of-art features:

- Fly-by-wire flight control
- Air-to-air missiles
- Air-to-ground rocket / missiles

4.1.5 To enable HAL to undertake the above R & D efforts to build up the necessary technological capabilities (which would be its capital asset) for the subsequent production of the ALH & the LCA to meet the Defence requirements, grants were given to HAL by the Government-Owner and Governmental Agencies. This was funded out of the National Defence Budget appropriated by the Parliament. The sanction of the President of India directing that design and development activities in one such case (ALH).

4.1.6 As already submitted, HAL has received funds from the Government – Owner for the conduct of defence related research of vital national and strategic importance which would result in acquisition by HAL of a capital asset in the form of indigenous and self reliant technology for the manufacture of ALH / LCA by HAL required for the defence of our nation. The technology built up as a result of the above R & D efforts would be applied by HAL in the manufacture & sale of defence equipment like ALH / LCA, income from which would in natural course, be offered to tax.

4.2 Treatment in books of accounts:

4.2.1 In respect of amounts received for R & D purposes:

4.2.1.1 There are two alternative methods by which such receipts can be recognised in the financial statements:

4.2.1.2 The first, whereby the amounts received as above (which are in the nature of Promoter - Owner's contribution) are taken directly to the Balance Sheet as a Capital Reserve, and the expenditure incurred is deducted directly in the Balance Sheet. In this case, the relevant entries made in the books of accounts would be as under:

Sl.	Particulars	Debit	Credit
(a)	Bank a/c . . . Capital Reserve / Fund . . . (on receipt of monies from Govt. for conduct of scientific research)	Xxxxxxxx	Xxxxxxxx
(b)	Capital Reserve/ Fund . . . Bank a/c . . (on incurrance of expenditure on scientific research)	Xxxxxxxx	xxxxxxx

4.2.1.3 The second, whereby the amounts received are taken initially to the Capital Reserve in the Balance Sheet. The expenditure incurred is debited to the profit and loss account and equivalent amounts are transferred from the Balance Sheet to the credit of the Profit & Loss Account as under:

Sl.	Particulars	Debit	Credit
(a)	Bank a/c . . . Research Fund / Advance . . . (on receipt of monies from the Govt for conduct of research)	Xxxxxxxx	xxxxxxx
(b)	Scientific Research expenditure . . . Bank a/c . . . (on incurrance of expenditure)	Xxxxxxxx	xxxxxxx
(c)	Profit & loss a/c . . . Scientific Research expenditure . . (On transfer to the Profit & Loss a/c)	Xxxxxxxx	xxxxxxx
(d)	Research Fund / Advance . . . Development . . . (with amount equivalent to the amount in Journal entry (c) above)	Xxxxxxxx	xxxxxxx
(e)	Development A/c . . . Profit & Loss account . . . (To ensure that no distortion to operating profit occurs)	Xxxxxxxx	xxxxxxx

4.2.2 Expenditure incurred on R & D purposes:

4.2.2.1 The expenditure incurred on R & D can be met directly by the Company or out of grants received for that purpose. HAL incurs both the above types of R&D expenditure.

4.2.2.2 The accounting method adopted by HAL is as under:

- a) Where HAL directly meets the R & D expenditure, the amount incurred is debited to the R & D Reserve in the Balance Sheet and is not debited to the Profit & Loss account; (It may be noted that this method of accounting does not affect the profit of the year);
- b) Where expenditure is met out the grants received by it, the expenditure incurred is debited to the Profit & Loss account and the amounts received towards the expenditure is credited to the Profit & Loss account under the head 'Development'. (This ensures the depiction of the correct operating profit).

17. At para 4.1.6 above it is admitted by the assessee that expenditure incurred out of the grants received from the government would result in acquisition by the assessee of a capital asset in the form of indigenous and self-reliant technology for the manufacture of LCH / LCA, which were

required for the defence of the country. Conditions of the Grant required the assessee to utilise it for the R & D of the LCA and LCH and related technology. Thus the expenditure incurred by the assessee using such grant which were debited to its profit and loss account were such that it would result in acquisition of a capital asset in the nature of indigenous self-reliant technology for manufacture of combat aircrafts and helicopter. As noted by the lower authorities such expenditure would be a part of the capital work-in-progress, and could not have been claimed by the assessee as revenue outgo. Before the AO, assessee itself has stated that once the LCA was developed and certified, it would be commercially produced and at that time revenue would be offered to tax. Thus there is an indirect admission by the assessee that expenditure incurred out of the grant resulted in acquisition of a capital asset. Once it is considered so, in our opinion, assessee could not claim such expenditure as revenue out go.

18. Now coming to the claim of the assessee that expenditure should be considered as eligible for deduction u/s.35(1)(iv) of the Act, CIT(A) had not admitted it considering it to be a fresh one. Section 35(1) (iv) of the Act is reproduced hereunder :

Section 35 (1) In respect of expenditure on scientific research, the following deductions shall be allowed—

(i)---

(ii)---

(iii)---

(iv) in respect of any expenditure of a capital nature on scientific research related to the business carried on by the assessee, such deduction as may be admissible under the provisions of sub-section (2):

19. Mandate as per the above section is that the expenditure claimed on scientific research shall allowed, provided it satisfies the conditions specified therein. What has been disallowed by the AO is R & D expenditure incurred by the assessee debited in its P & L account. Such R & D expenditure as per the assessee's audited final accounts came to Rs.67,478.11 lakhs and the break up of this has been given at paper book page.145 as under :

Research and Development Expenditure		(Rs. in Lakhs)	
Expenditure In R & D included in :	Current Year	Previous Year	
Raw Material Consumption	25869.69	24216.89	
Direct Expenses	10049.88	715.57	
Salaries and Wages	23439.25	15429.30	
Other expenses	3102.41	6867.52	
Interest			
Depreciation	939.22	1141.69	
Provisions	297.60	30.25	
Inter Services /Common Services	3780.06	3293.33	
Total R & D Expenditure	67478.11	51694.55	

20. Assessee having claimed the expenditure as part of revenue outgo through its P & L account, when the AO found that such claim was not allowable considering it to be a capital out go, in our opinion, he ought

have allowed a deduction as mandated u/s.35(1) of the Act. Section says assessee which satisfies the conditions set out therein shall be allowed and there is no condition therein which disentitles an assessee from getting this benefit for want of a specific claim. Nevertheless we find that CIT (A) has given a finding that assessee was not doing any scientific research, but only R & D. We are unable to appreciate this finding of the CIT (A). Development of avionics for modern LC air-craft and helicopter, radar systems for fighter aircrafts, requires considerable scientific research and cannot be considered as mere R & D expenditure. Definition of scientific research as given in Section 43(4) of the Act, brings within its fold any activity for the extension of knowledge in the field of natural or applied science. To say that research that goes into development of modern LCA or helicopter is not an activity for the expansion of knowledge of applied science is, in our opinion, will be incorrect and far from truth. Thus assessee had every right to say that it was engaged in scientific research and deduction u/s.35(1)(iv) of the Act, was available to it. CIT (A) in our opinion, erred in considering it to be a fresh claim which required filing of a revised return. Judgment of Hon'ble Apex Court in the case of Goetze (India) Ltd (supra) only limits the power of the AO to consider a new claim but does not limit the powers of appellate authorities in any way. However the question as to what could be the amount of scientific research

expenditure on which assessee is eligible for claim of deduction u/s.35(1) of the Act, require verification since it need not be equal to the grant amount received by the assessee. It could be either more or less. This aspect, in our opinion, requires a fresh look by the lower authorities. Thus, though assessee's claim that expenditure against government grant were wholly allowable as Revenue outgo is incorrect, it cannot be denied deduction available to it under section 35(1)(iv) of the Act, if it can show that other conditions set out therein are satisfied. Thus we uphold the order of the lower authorities, in so far as disallowance of expenditure is considered. However, vis-a-vis claim of the assessee it ought have been given deduction u/s.35(1)(iv) of the Act, to the extent it was eligible, we set aside the orders of the lower authorities and remit it back to the file of AO for consideration afresh in accordance with law. Ground 2 of the assessee is dismissed, whereas ground 3 is allowed for statistical purpose.

21. Vide its ground 4, grievance raised by the assessee is that disallowance of Rs.15,18,810/- made by the AO u/s.14A of the Act, was sustained by the CIT (A).

22. Facts apropos are that assessee had claimed dividends of Rs.62.18 lakhs as exempt u/s.10(34) of the Act. As per the assessee it had incurred

no expenditure in relation to earning of such dividend income. Assessee also claimed that investments resulting in the dividends were for strategic purpose and Section 14A of the Act would not be attracted. However, AO was not impressed. According to him, even though there was no direct or indirect interest expenditure, assessee would have incurred other indirect expenditure calling for application of Rule 8D(2)(iii) of the IT Rules. Considering 0.5% of the average amount of investments, AO made a disallowance of Rs.15,80,810/-.

23. Aggrieved assessee moved in appeal before the CIT (A). Reliance was placed on the judgment of Hon'ble Delhi High Court in the case of Maxopp Investments Ltd v. CIT [347 ITR 272]. As per the assessee investments made by the assessee were strategic in nature and in group companies. However CIT (A) was not impressed. According to him, AO could invoke Rule 8D, even where assessee claimed no expenditure to have been incurred in relation to the exempt income. He upheld the disallowance.

24 Now before us, Ld. AR strongly assailing the orders of lower authorities submitted that AO without expressing satisfaction which was necessary to be reached with regard to assessee's claim that no expenditure was incurred for earning the exempt income, had proceeded to automatically apply the Rule. Relying on the decision of coordinate bench

in the case of DCIT v. Subramanya Constructions & Development Co. Ltd [ITA No.404/Bang/2015 & CO .89/Bang/2013, dt.20.02.2015], Ld. AR submitted that AO was bound to make a verification even when there was a claim by the assessee when there was no expenditure incurred by invoking Section 14A and Rule 8D.

25. Per contra, Ld. DR supported the orders of the lower authorities.

26. We have perused the orders and heard the rival contentions. Reliance placed by the assessee is on a decision of coordinate bench in the case of Subramanya Constructions & Development Co. Ltd (supra). In the said case, dividend income earned was Rs.33,600/- on shares worth Rs.2,30,400/- held in Indian Overseas Bank. Holding of the assessee was the very same at the beginning of the year and at the end of the year. In other words, there were no incremental investments. It was on account of this reason that Tribunal held that the claim of no expenditure was to be accepted unless AO had recorded his dissatisfaction thereon. As against this, in the given case before us, it is an accepted position that there was substantial change in the investments held by the assessee as at the beginning of the year and at the ending of the year. Dividend income of Rs.62.18 lakhs claimed was not an insignificant sum. Therefore, in our opinion, decision of the coordinate bench in the case of Subramanya

Constructions & Development Co. Ltd, would not come to the aid of the assessee. For the assessee to say that no expenditure was incurred even when it was holding substantial investments was prima facie incorrect. What we note is that AO had made disallowance under Rule 8D(2)(iii) of the IT Rules, only for indirect expenditure. Argument of the assessee that the investments were for strategic purpose has not been substantiated and even if true, it cannot be disputed that it had earned substantial dividend of Rs.62.18 lakhs during the relevant year. We are alive to the judgment of the Hon'ble Delhi High Court in the case of Maxopp Investments Ltd (supra), where it was held that AO necessarily had to express his dissatisfaction on the inadequacy of the expenditure disallowed suo motu, by the assessee before invoking Section 14A of the Act. However this judgment cannot be stretched to include in its fold cases where no expenditure was claimed to have been incurred despite substantial holdings in investment, despite substantial change in investments and despite earning of substantial dividend income. We are therefore of the opinion that disallowance of 0.5% the average investments made under Rule 8D(2)(iii) of the Rules, was justified. No interference is required. Ground four stands dismissed.

27. In the result, appeal of the assessee is partly allowed for statistical purpose.

Order pronounced in the open court on 22nd day of April, 2016.

Sd/-

(VIJAY PAL RAO)
JUDICIAL MEMBER

Sd/-

(ABRAHAM P GEORGE)
ACCOUNTANT MEMBER

MCN

Copy to:

1. The assessee
2. The Assessing Officer
3. The Commissioner of Income-tax
4. Commissioner of Income-tax(A)
5. DR
6. GF, ITAT, Bangalore

By Order

Assistant Registrar