

**IN THE INCOME TAX APPELLATE TRIBUNAL
KOLKATA BENCH "D" KOLKATA**

Before Hon'ble **Shri Waseem Ahmed, Accountant Member** and
Shri S.S.Viswanethra Ravi, Judicial Member

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| I.T.A. No.681/Kol/2015 Assessment Year : 2010-11 |
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| M/s.Kalyani Barter (P)Ltd.,2 nd Floor, Room No.5, 2, Ganesh Chandra Avenue, Kolkata-700013. PAN : AACCK 7579 D | V/s. | I.T.O., Ward-2(3) P-7, Chowringhee Square, Kolkata-700069. |
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| अपीलार्थी /Appellant | .. | प्रत्यर्थी/Respondent |

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| I.T.A. No.824/Kol/2015 Assessment Year : 2010-11 |
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| I.T.O., Ward-2(3) P-7, Chowringhee Square, Kolkata-700069. | V/s. | M/s.Kalyani Barter (P)Ltd.,2 nd Floor, Room No.5, 2, Ganesh Chandra Avenue, Kolkata-700013. PAN : AACCK 7579D |
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| अपीलार्थी /Appellant | .. | प्रत्यर्थी/Respondent |

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| अपीलार्थी की ओर से/By Assessee | Shri Subash Agarwal, Advocate |
| प्रत्यर्थी की ओर से/By Department | Shri Tanuj Neogi, JCIT |
| सुनवाई की तारीख/Date of Hearing | 12.01.2017.. |
| घोषणा की तारीख/Date of Pronouncement | 03 .03.2017. |

आदेश /ORDER

Per Waseem Ahmed, AM

This appeal by the assessee is against the order of Commissioner of Income Tax (Appeals)-1, Kolkata dated 17.02.2015. Assessment was framed by

I.T.O., Ward-2(3), Kolkata u/s 143(3) of the Income tax Act, 1961 (hereinafter referred to as 'the Act ') vide his order dated 18.03.2013 for assessment year 2010-11.

2. Brief facts of the interconnected issue are that the assessee, a private limited company, is engaged in the business of trading in shares & securities. The Assessing Officer while completing assessment under section 143(3) of the Act noticed that the assessee has earned dividend income of Rs. 41,375.00 in the year under consideration which was offered to tax under the head business income in its computation of income. The assessee neither showed dividend income as income from other sources nor claimed any exemption on such income under section 10(34) of the Act. However the AO was of the view that the assessee should have claimed exemption on such income and accordingly should have disallowed the expenses in pursuance to the provisions of section 14A of the Act. Therefore the AO called upon the assessee to explain/ clarify the facts as discussed above. However the reply made by the assessee was not satisfactory to the AO and therefore he invoked the provisions of rule 8D read with section 14A of the Act for the purpose of disallowance as detailed below :

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| i. | Direct expenses | Rs. 3,07,891.00 |
| ii. | Interest expenses | Rs. 34,42,257.00 |
| iii. | Administrative expenses | Rs. 4,79,724.00 |

However the disallowance of administrative expenses were limited to Rs. 2,40,279.00 by the AO as these are the actual expenses. As per the AO the disallowance of administrative expenses cannot exceed the actual expenses claimed by the assessee. At the end the AO disallowed a sum of Rs.42,29,872.00 under the provisions of section 14A read with rule 8D of income tax rules and added to the total income of the assessee.

3. On appeal to the Commissioner of Income tax (Appeals), the assessee submitted that the action of the AO is not correct as the income from the dividend was offered to tax. The main and the dominant business of the assessee was the trading of shares and the shares were treated as stock in trade. The income earned on the sale and purchase of shares was offered to tax. The dividend income is incidental to the main business which is extra income earned by the assessee during the year.

The learned CIT-A after considering the submission of the assessee deleted the addition made by the AO under the provisions of rule 8D2(ii) and (iii) of Income Tax Rules by observing that the assessee is engaged in the business of shares trading and the shares were classified as stock in trade in its books of accounts. Therefore the assessee is entitled for the deduction of interest expenses and administrative expenses. While holding so the learned CIT-A relied in the order of Hon'ble ITAT in the case of DCIT Vs. Gulshan Investment Company Ltd reported in 31 taxman.com 113.

However the learned CIT-A observed that the direct expenses incurred on the earning of dividend income even held as stock-in-trade by the assessee as per rule 8D2(i) of Income Tax Rules are not eligible for deduction. As such the learned CIT A has given relief to the assessee in part by observing as under :

5... The submissions of the Appellant and the case laws relied upon by it have been considered. It is seen that the issue is in respect of disallowance u/s.14A by applying Rule 80 In respect of proportionate expenses for earning of exempt Income I.e. dividend income of [3.5.41,375/-. The Appellant's contention in brief is that since it was engaged in trading of Shares, the provisions of Section 14A read with Rule 80 were not applicable in its case. In this regard, the ITAT, Mumbai in DCIT Vs. India Advantage Securities Ltd. in ITA 6711/Mum/2011 has held that since taxpayers did not retain Shares with the intention of earning dividend income and such income was incidental to business of sales of Shares, no disallowance of expenditure incurred on borrowings made for purchase of trading Shares could be made u/s.14A of the Income Tax Act. A similar view has been held in C.C.I. Ltd. Vs. JCIT 206 Taxman 56. However, the jurisdictional Tribunal in DCIT Circle-6 vs Gulshan Investment Co Ltd 31 Taxman.com 113(Kol) has held as under :-

"6. A plain look at the above rule shows that 8 D(2)(ii) and (iii) can only be applied in the situations in which shares are held as investments, and that this rule will not have any application when the shares are held as stock in trade. It is so for the elementary reason

that the one of the variables on the basis of which disallowance under rules 8D(2)(ii) and (iii) is to be computed is the value of "investments, income from which does not or shall not form part of total income", and, when there are no such investments, the rule cannot have any application. When no amount can be computed in the light of the formula given in rule 8 D(2)(ii) and (iii) , no disallowance can be made under rule 8D (2)(ii) and (iii) either. As held by Hon'ble Supreme Court in the case of CIT v. B C Srinivasa Setty [1981] 128 ITR 294/5 Taxman 1 when computation provisions fail, the charging provisions cannot be applied. and by the same logic, when the computation provisions under rule 8 D (2) (ii) and (iii) fail, disallowance under the said provisions cannot be made either as the said provision is rendered unworkable.

7. However, that does not exclude the application of rule 8 D(2)(i) which refers to the "amount of expenditure directly relating to income which does not form part of total income". In other words, in a case where shares are held as stock in trade and not as investments; the disallowance even under rule 8 D is restricted to the expenditure directly relating to earning of exempt income. Consequently, while Section 14A will still apply in the cases whether shares are held as stock in trade or as investments, and that is precisely what a Special Bench of this Tribunal has held in the case of ITO v. Daga Capital Management (P.) Ltd. [2009] 117 ITD 169 (Mum) the disallowance to be made under section 14 A read with rule 8 D will be restricted to direct expenses incurred in the earning of dividend income. "

Therefore, considering the above decisions and the fact that the Appellant was trading in Shares, the same were being held as stock-in-trade which is apparent from the Balance Sheet i.e. the Shares on which exempt income had been earned were part of its stock-in-trade and not investment. Therefore, following the above decision it is held that while the indirect expenses covered under Rule 8D (ii) and (iii) were not disallowable in view of the Shares being stock-in-trade. However, regarding applicability of Rule 8D(i) following the above cited decision of Hon'ble I.T.A.T., Kolkata, it is held that the disallowance is to be restricted to direct expenses incurred in earning of dividend income i.e. disallowance of direct expenses is to be made even when Shares are held as "stock-in-trade." The A.O. is accordingly directed to re-compute the disallowance u/s.14A and restrict the same to the disallowance of direct expenses incurred by the Appellant for earning of the exempt income.

Being aggrieved by the order of learned CIT-A, Both assessee and the Revenue are in appeal before us on the following grounds of appeals.

4. Assessee in its appeal No. 681/kol/2015 has raised following grounds of appeal :

"1. For that the Ld. Commissioner of Income Tax (Appeal)-I/Kol has erred in law as well as on facts of the case in directing the Assessing Officer to recompute the disallowance u/s.14A and restrict the same to the disallowance of direct expenses incurred by the appellant for earning the exempt income on the grounds which are not correct.

2. For that the Ld. Commissioner of Income Tax (Appeal)-II Kol has erred in law as well as on facts of the case in confirming the dividend income of Rs.

41,375.00 as exempt income instead of income from business on the grounds which are not correct.

3. For that the appellant craves leave to adduce, modify and/or alter the grounds at or before hearing.”

Revenue in its appeal No. 824/Kol/2015 has raised following grounds of appeal :

“1. That on the facts and circumstances of the case, the Ld. CIT(A)-I, Kolkata had erred in allowing relief against the disallowance of Rs.39,90,427/- made u/s. 14A of the Income Tax Act 1961.

2. That tax effect in the instant case is also much above the monetary limit as prescribed vide CBDT's instruction No.3/2011 & instruction NO.5/2014 for filing of appeal before Ld.ITAT, Kolkata.

3. That the appellant craves leave to amend, modify or alter any grounds of appeal during the course of hearing of this case.”

5. First we take up assessee's appeal No. 681/kol/2015 for adjudication.

At the outset Id. AR before us fairly agreed for the disallowances made by the lower authorities under the provisions of rule 8D(i) of Income Tax Rules. Therefore the ground of appeal filed by the assessee is hereby dismissed.

Now we take up Revenue's appeal No. 824/Kol/2015 for adjudication.

6. The Id. D.R. before us relied on **CBDTs Circular No. 5/2004 dated 11.02.2014**, wherein it has been further clarified and emphasized that legislative intent behind introduction of section 14A is to allow only that expenditure which is relatable to earning of income and it, therefore, follows that the expenses, which are relatable to exempt income are to be considered for disallowance. Thus the disallowance of expenses is required under section 14A of the Act even in relation to the investment held as stock in trade. The Id. AR vehemently supported the order of AO.

7. The Id. counsel for the assessee, on the other hand, strongly supported the impugned order of the Id. CIT (Appeals) holding that section 14A and Rule 8D have no application to make a disallowance on account of expenditure in relation to the exempt dividend income which is earned on shares held as stock-in-trade and not investment.

The Id. counsel for the assessee also cited the decision of the Hon'ble Punjab & Haryana High Court in the case of *CIT v. Winsom Textile Industries Ltd.* reported in 319 ITR 204 wherein it was held that section 14A of the Act could not apply when the assessee had not made any claim for exemption of dividend income in its income tax return.

Without prejudice to his main argument and as an alternative, the Id. counsel for the assessee contended that the disallowance under section 14A has been wrongly worked out by the Assessing Officer under Rule 8D by taking the entire value of stock-in-trade instead of taking the value of shares, which actually yielded dividend income during the year under consideration. In this regard, he relied on the decision of the Coordinate Bench of this Tribunal in the case of *REI Agro Ltd. v. Dy. CIT* [2013] 35 taxmann.com 404/144 ITD 141 (Kol.), wherein it was held that the value of only those shares are required to be considered in computation as per Rule 8D, which have yielded dividend income. He pointed out that the said decision rendered by the Coordinate Bench of this Tribunal in the case of *REI Agro Ltd. (supra)* has been affirmed by the Hon'ble Calcutta High Court vide its order dated 19.04.2014 in ITAT No. 220 of 2013. He contended that even if section 14A read with Rule 8D is held to be applicable in the case of the assessee, the Assessing Officer may be directed to compute the disallowance as per Rule 8D by taking into consideration only those shares, which have yielded dividend income in the year under consideration.

8. We have considered the rival submissions and also perused the relevant material available on record. The issue that arises for our consideration in the present context is whether the provisions of section 14A can be invoked to make a disallowance on account of expenditure incurred in relation to the exempt income in the form of dividend received by the assessee on the shares held as stock-in-trade.

Admittedly the assessee is into the business of share trading predominantly and all the shares have been classified as stock in trade. All the expenses either directly or indirectly have been incurred for the business of the assessee including the finance charges on the borrowed fund. The dividend income earned on the shares held as stock in trade is incidental income of the assessee. The predominant income of the assessee is from the trading of shares which has already been offered to tax. Indeed the assessee while carrying out its activities has earned income in the form of dividend which is exempted from tax under section 10(34) of the Act.

However on this aspect the provisions of the act are fairly clear which states that the expenses incurred by the assessee in relation to exempted income will be disallowed from the income of taxable activities. In the case on hand there is no dispute that the assessee has earned exempted income and therefore the expenses incurred in relation to such income has to be disallowed. In the instant case the assessee has not disallowed any expenses on the ground that the assessee has not claimed any exemption of dividend income under section 10(34) of the Act rather the dividend income was offered to tax. Therefore the ld. AR argued that no disallowance under section 14A of the Act is warranted.

However we disagree with the contention of the learned AR on the ground that the intention of the legislature is to collect tax on the income which is chargeable to tax. The revenue is not authorized to collect the tax on those activities which

are not chargeable to tax under the Act. It is the duty of the Revenue to exclude those items of income from the taxable income which are not chargeable to tax in spite of the fact that the assessee has offered the same to tax. In this connection we rely in the judgment of the Hon'ble Supreme Court of India in the case of The relevant extract of the case UNITED COMMERCIAL BANK vs. COMMISSIONER OF INCOME TAX (1999) 156 CTR 0380 : (1999) 240 ITR 0355 (1999) 106 TAXMAN 0601 whereby Hon'ble SUPREME COURT OF INDIA held as under :

"for the purpose of income-tax whichever method is adopted by the assessee a true picture of the profits and gains, that is to say, the real income is to be disclosed. For determining the real income, the entries in a balance sheet required to be maintained in the statutory form, may not be decisive or conclusive. In such cases, it is open to the ITO as well as the assessee to point out the true and proper income while submitting the IT return."

Now coming to the facts of the case we find that the controversy whether the disallowance is to be made under section 14A of the Act in relation to those shares which are held as stock in trade has been settled by the Hon'ble Calcutta High Court in the case of Dhanuka & Sons Vs. CIT(2011) reported in 339 ITR 319. The relevant extract of the order is reproduced below :

"The object of s. 14A is to disallow the direct and indirect expenditure incurred in relation to income which does not form part of the total income. There is no dispute that part of the income of the assessee from its business is from dividend which is exempt from tax whereas the assessee was unable to produce any material before the authorities below showing the source from which shares were acquired. The mere fact that those shares were old ones and not acquired recently is immaterial. It is for the assessee to show the source of acquisition of those shares by production of materials that those were acquired from the funds available in the hands of the assessee at the relevant point of time without taking benefit of any loan. If those shares were purchased from the amount taken in loan, even for instance, five or ten years ago, it is for the assessee to show by the production of documentary evidence that such loaned amount had already been paid back and for the relevant assessment year, no interest is payable by the assessee for acquiring those old shares. In the absence of any such materials placed by the assessee, the authorities below rightly held that proportionate amount should be disallowed having regard to the total income and the income from the exempt source. In the absence of any material disclosing the source of acquisition of shares which is within the special knowledge of the assessee, the assessing authority took a most reasonable approach in assessment."

In view of the above we find that the provisions of section 14A of the Act are very much attracted on those investments which are held as stock in trade.

However before us, the Id. counsel for the assessee has raised an alternative contention that even if section 14A read with Rule 8D is held to be applicable in the case of the assessee, the Assessing Officer may be directed to compute the disallowance as per Rule 8D by taking into consideration only those shares which have yielded dividend income in the year under consideration. Since this issue raised by the Id. counsel for the assessee as an alternative contention is squarely covered in favour of the assessee by the decision of the Coordinate Bench of this Tribunal in the case of *REI Agro Ltd. (supra)*, we direct the Assessing Officer to compute the disallowance as per Rule 8D by taking into consideration only those shares, which have yielded dividend income in the year under consideration. The alternative contention of the Id. counsel for the assessee is accordingly accepted. Ground No. 1 of the revenue's appeal is thus partly allowed.

In the result the assessee's appeal is dismissed and the revenue's appeal is partly allowed.

Order pronounced in the Court on 03.03.2017.

Sd/-

[S.S.Viswanethra Ravi]

Judicial Member

Sd/-

[Shri Wassem Ahmed]

Accountant Member

Dated : 03.03.2017

{SC SPS}

Copy of the order forwarded to:

1. Appellant/Assessee – M/s. Kalyani Barter (P)Ltd.
2. Respondent –I.T.O. Ward – 2 (3), Kolkata.
3. CIT(A)- Kolkata.
4. CIT – , Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.

True copy

By Order

Asstt.Registrar, ITAT, Kolkata Benches