IN THE INCOME TAX APPELLATE TRIBUNAL
"F" Bench, Mumbai

Before Shri Jason P. Boaz, Accountant Member
and Shri Sandeep Gosain , Judicial Member

ITA No. 2801/Mum/2012
(Assessment Year: 2008-09)

M/s. Capital First Ltd. (formerly Future Capital Holdings Ltd.) India Bulls Finance Centre Tower 2, 15th Floor, Senapati Bapat Marg, Elphinston (W) Mumbai 400013	Vs.	Add. CIT, Range – 8(1) Aayakar Bhavan M.K. Road Mumbai 400020

PAN – AACCK6863C

Appellant **Respondent**

ITA No. 2137/Mum/2012
(Assessment Year: 2008-09)

Add. CIT, Range – 8(1) Aayakar Bhavan M.K. Road Mumbai 400020	Vs.	M/s. Capital First Ltd. (formerly Future Capital Holdings Ltd.) India Bulls Finance Centre Tower 2, 15th Floor, Senapati Bapat Marg, Elphinston (W) Mumbai 400013

PAN – AACCK6863C

Appellant **Respondent**

Assessee by: Shri Manish Desai
Revenue by: Ms. Pooja Swaroop

Date of Hearing: 15.11.2016
Date of Pronouncement: 18.11.2016

O R D E R

Per Jason P. Boaz, A.M.

These are cross appeals, one by the assessee and the other by Revenue, directed against the order of the CIT(A)-16, Mumbai dated 05.01.2012 for A.Y. 2008-09.

2. The facts of the case, briefly, are as under: -

2.1 The assessee is an NBFC incorporated on 18.10.2005 and also engaged in investment advisory activities, treasury and wholesale credit

activities and retail financial services. For A.Y. 2008-09, the assessee filed its return of income on 29.08.2008 declaring loss of ₹3,92,97,426/-. Subsequently, a revised return of income was filed on 02.03.2010 declaring loss of ₹3,92,97,426/-. The return was processed under section 143(1) of the Act of the Income Tax Act, 1961 (in short 'the Act') and the case was then taken up for scrutiny. The assessment was completed under section 143(3) of the Act of the Act vide order dated 24.12.2010; wherein the assessee's loss was determined at ₹1,94,76,340/-, inter alia, in view of the following additions/disallowances: -

(i)	Advertisement	₹70,50,500/-
(ii)	Disallowance under section 14A	₹94,11,637/-
(iii)	Club Membership	₹16,62,928/-
(iv)	Expenses for increase in share capital	₹94,11,637/-

2.2 Aggrieved by the order of assessment dated 24.12.2010 for A.Y. 2008-09, the assessee preferred an appeal before CIT(A)-16, Mumbai. The learned CIT(A) disposed off this appeal vide order dated 04.01.2012 allowing the assessee partial relief.

3. The assessee and Revenue being aggrieved by the order of the learned CIT(A)-16, Mumbai dated 04.01.2013 for A.Y. 2008-090 have preferred cross appeals.

3.1 **Revenue's appeal in ITA No. 2137/Mum/2012 for A.Y. 2008-09**

Revenue has raised the following grounds of appeal: -

"(i) On the facts and in the circumstances of the case and in law, the Ld. CIT(A) failed to interpret the provisions of section 14A of the Income Tax Act, 1961 and Rule 8D in its right perspective and true meaning.

(ii) On the facts and in the circumstances of the case and in law, the Ld. CIT(A) deleted the disallowance made by the A.O. of Rs.1,05,54,142/- u/s.14A of the Act on the ground that there was no actual expenditure incurred by the assessee for earning the exempt income without appreciating the fact that the disallowance was rightly made by the A.O. as per Rule 8D which is applicable w.e.f. A.Y. 2008-09.

(iii) On the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in treating the expenditure incurred for advertisement films as revenue in nature without appreciating the

fact that the assessee becomes owner of the advertisement films which are reusable over indefinite period of time and which gives enduring benefit to the assessee.

2. The appellant prays that the order of the CIT(A) on the above grounds be set aside and that of the A.O. be restored."

3.2 **Assessee's appeal in ITA No. 2891/Mum/2012 for A.Y. 2008-09**

Assessee has raised the following grounds of appeal: -

"1. ***Disallowance under section 14A of the Act – Rs.1,05,54,142/-***

(a) The Commissioner of Income-tax (Appeals) -16, Mumbai [CIT(A)] has erred in not accepting the legal plea raised by the appellant during the course of appellate proceedings that only Rs.9,46,325/- is disallowable u/s 14A of the Act, without giving any finding/reasoning for such non acceptance.

(b) The appellant prays that since the disallowance as per the provisions of section 14A cannot be higher than Rs.9,46,325/-, the excess disallowance be deleted.

2. ***Leave to add, alter and/or supplement Grounds of Appeal***

The appellant craves leaves to add, alter, and supplement any ground or grounds, if necessary, at the time of hearing of the appeal."

4. **Grounds (i) & (ii) of Revenue's appeal & ground 1 of assessee's appeal – Disallowance under section 14A r.w. Rule 8D**

4.1 In these grounds (supra) Revenue has assailed the impugned order of the learned CIT(A) in deleting the disallowance of ₹1,05,54,142/- made by the AO under section 14A r.w. rule 8D on the ground that there was no actual expenditure incurred by the assessee for earning the exempt income without appreciating the fact that the disallowance was rightly made under Rule 8D. The learned D.R. was heard in support of the grounds raised and placed strong reliance on the decision of the AO in disallowing an amount of ₹1,99,65,779/- under section 14A r.w. rule 8D (wrongly mentioned as ₹1,05,54,142/- in the grounds raised) which was restricted by the learned CIT(A) to ₹1,05,54,142/-, the suo moto disallowance made by the assessee. It was prayed that the finding of the learned CIT(A) be reversed and that of the Assessing Officer (AO) restored on this issue.

4.2 On the other hand, the assessee in its ground (supra) has assailed the action of the learned CIT(A) in the impugned order in not accepting the legal plea it raised in the course of appellate proceedings that only an

amount of ₹9,46,325/- is disallowable under section 14A r.w rule 8D, without assigning any reason for such non-acceptance. It is pleaded that this ground be considered on merits.

4.3.1 We have heard the rival contentions and perused and carefully considered the material on record. The facts of the matter that emanates from the record are that in the course of assessment proceedings, the AO observed that the assessee had earned exempt income of ₹72,32,077/- and had suo moto disallowed an amount of ₹1,05,54,142/- as being amount of deduction inadmissible in terms of section 14A of the Act. The AO was of the view that the aforesaid suo moto disallowance made by the assessee has not been correctly carried out as per the provisions of rule 8D of the I.T. Rules, 1962 and proceeded to compute the disallowance under section 14A r.w. rule 8D at ₹1,99,65,779/-. On appeal, the assessee challenged this disallowance of ₹199,65,779/- made by the AO under section 14A r.w. rule 8D, seeking deletion of the same entirely. Without prejudice to this, the assessee also contending that if at all disallowance under section 14A r.w. rule 8D was to be made, AO should have excluded interest income directly attributable to any taxable income; under rule 8D the AO ought not to have considered investment in such debentures, share warrants, the income of which is not exempt from tax etc. At para 2.2.2 of the impugned order it is also noted by the learned CIT(A) that the assessee had further submitted that the disallowance under section 14A of the Act should be restricted to ₹9,46,325/- and contended that the learned CIT(A) should entertain and allow the assessee's claim, if permissible in law, even though that claim was not made in the return of income, but was made in the course of assessment proceedings or appellate proceedings.

4.3.2 On a perusal of the findings rendered by the learned CIT(A) in the impugned order, wherein he has sustained the disallowance of ₹1,99,65,779/- made by the AO under section 14A r.w. rule 8D to ₹1,05,54,512/-, we find that the learned CIT(A) has not addressed the assessee's claim that the disallowance under section 14A r.w. rule 8D

should be restricted to ₹9,46,325/-. In his finding at paras 2.3.1 to 2.3.4 of the impugned order the learned CIT(A) has held as under: -

"2.3.1 I have carefully considered the contentoin of the appellant company as well as carefully gone through the available documents on record. I find tht this issue has been decided by the Hon'ble Bombay High Court in the case of ***Godrej & Boyce Mfg Co. Ltd. Vs DCIT Range 10(2), (2010) 328 ITR 81*** *while concluding the issue the Hon'ble Court has held as under: -*

i) Dividend income and income from mututal funds fallling within the ambit of Section 10(33) of the Income Tax Act 1961, as was applicable for Assessment Year 2002-03 is not includible in computing the total income of the assessee. Consequently, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income under the Act by virtue of the pos 14(A)(1);

ii) The payment by a domestic company under Section 115O(1) of additional income tax on profits declared, distributed or paid is a charge on a component of the profits of the company. The company is chargeable to tax on its profits as a district taxable entity and it pays tax in discharge of its own liability and not on behalf of or as an agent for its shareholders. In the hands of the shareholder as the recipient of dividend, income by way of dividend does not form part of the total income by virtue of the pos 10(33). Income from mutual finds stands on the same basis;

iii.) The provisions of sub sections (2) and (3) of Section 14A of the Income Tax Act 1961 are constitutionally valid;

iv) The provisions of Rule 8D of the Income Tax Rules as inserted by the Income Tax (Fifth Amendment) Rules 2008 are not ultra vires the provisions of section 14A, more particularly sub section (2) and do not offend Article 14 of the Constitution;

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

vi) Even prior to Assessment Year 2008-09, when Rule 8D was not applicable, the Assessing Officer has to enforce the provisions of sub section (7) of Section 14A. For that purpose, the Assessing Officer is duty bound to determine the expenditure which has been incurred in relation to income which does not firm part of the total income under the Act. The Assessing Officer must adopt a reasonable basis or method consistent with all the relevant facts and circumstances after furnishing a reasonable opportunity to the assessee to place all germane material on the record;

vii) The proceedings for Assessment Year 2002-03 shall stand remanded back to the Assessing Officer. The Assessing Officer

shall determine as to whether the assessee has incurred any expenditure (direct or indirect) in relation to dividend income/ income from mutual funds which does not form part of the total income as contemplated under Section 14A. The Assessing Officer can adopt a reasonable basis for effecting the apportionment. While making that determination, the Assessing Officer shall provide a reasonable opportunity to the assessee of producing its accounts and relevant or germane material having a bearing on the facts and circumstances of the case.

2.3.2 The Hon'ble SC, in the case of CIT vs. Walfort Share & Stock Brokers (P.) Ltd. reported in 192 TAXMAN 211 (SC). has observed that the insertion of section 14A with retrospective effect is the serious attempt on the part of the Parliament not to allow deduction in respect of any expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act against the taxable income (see Circular No. 14 of 2001 dated 22-11-2001). In other words, section 14A clarifies that expenses incurred can he allowed only to the extent they are relatable to the earning of taxable income. In many cases, the nature of expenses incurred by the assessee may be relatable partly to the exempt income and partly to the taxable income. In the absence of section 14A, the expenditure incurred in respect of exempt income was being claimed against taxable income. The mandate of section 14A is clear. It desires to curb the practice to claim deduction of expenses incurred in relation to exempt income against taxable income and at the same time, avail the tax incentive by way of exemption of exempt income without making any apportionment of expenses incurred in relation to exempt income. The basic reason for insertion of section 14A is that certain incomes are not includible while computing total income as these are exempt under certain provisions of the Act. In the past, there have been cases in which deduction has been sought in respect of such incomes which in effect would mean that tax incentives to certain incomes was being used to reduce the tax payable on the non-exempt income by debiting the expenses incurred to earn the exempt income against taxable income. The basic principle of taxation is to tax the net income, i.e., gross income minus the expenditure. On the same analogy, the exemption is also in respect of net income. Expenses allowed can only be in respect of earning of taxable income. This is the purport of section 14A. In section 14A, the first phrase is "for the purposes of computing the total income under this Chapter" which makes it clear that various heads of income as prescribed under Chapter IV would fall within section 14A. The next phrase is 'in relation to income which does not form part of total income under the Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14A. Further, section 14 specifies five heads of income which are chargeable to tax. In order to be chargeable, an income has to be brought under one of the five heads. Sections 15 to 59 lay down the rules for computing income for the purpose of chargeability to tax under those heads. Sections 15 to

59 quantify the total income chargeable to tax. The permissible deductions enumerated in sections 15 to 59 are now to be allowed only with reference to income which is brought under one of the above heads and is chargeable to tax. If an income like dividend income is not a part of the total income, the expenditure/deduction, though of the nature specified in sections 15 to 59 but related to the income not forming part of total income, could not be allowed against other income includible in the total income for the purpose of chargeability to tax. The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14A.

2.3.3 The Hon'ble SC further observed that the scheme of sections 30 to 37 is that profits and gains must be computed subject to certain allowances for deductions/expenditure. The charge is not on gross receipts; it is on profits and gains. Profits have to be computed after deducting losses and expenses incurred for business. A deduction for expenditure or loss which is not within the prohibition must be allowed if it is on the facts of the case a proper debit item to be charged against the incomings of the business in ascertaining the true profits. A return of investment or a pay-back is not such a debit item as explained above and, hence, it is not 'expenditure incurred' in terms of section 14A. Expenditure is a pay-out. It relates to disbursement. A pay-back is not an expenditure in the scheme of section 14A. For attracting section 14A, there has to be a proximate cause for disallowance, which is its relationship with the tax exempt income and since pay-back or return of investment is not such proximate cause, section 14A was not applicable in the instant case. Thus, in the absence of such proximate cause for disallowance, section 14A could not be invoked. Return of investment could not be construed to mean 'expenditure' and if it was construed to mean 'expenditure' in the sense of physical spending, still the expenditure was not such as could be claimed as an 'allowance' against the profits of the relevant accounting year under sections 30 to 37 and, therefore, section 14A could not be invoked. Hence, the two asset theory was not applicable in the instant case as there was no expenditure incurred in terms of section 14A.

2.3.4 Therefore, in both cases i.e in Godrej & Boyce Mfg. Co. Ltd. vs. Dy. CIT (2010) 234 CTR (Bom) 1, the Hon'ble Bombay High Court has held that in order to disallow the expenditure under s. 14A there should be some expenditure actually incurred for earning the exempt income. Thus, the primary condition for disallowance is factual incurrence of expenditure in relation to the income not forming the part of the total income. Similar view was expressed by the Hon'ble Supreme Court in the case of Walfort Share & Stock Brokers (P) Ltd. (2010) 233 CTR SC) 42. The Ld. AO has mechanically undertaken the exercise of computing the disallowances of expenditure as per Rule 8D without finding any faults or incorrectness in the disallowances offered by the appellant in its computation. Further, as pointed out by the appellant said computation' suffers from the taking the figures of investment and attributing the cost of interest expenses. The appellant

has pointed out that the money borrowed on interest has been actually utilized for earning the income which is taxable and the interest income so earned has been also offered to tax by it. Further, the investment in share application money debentures and share warrants are not exempt from the levy of income tax should not have been part of the disallowances. In view of the foregoing, I am of the confirmed view that the provisions of section 14A are not rightly invoked by the Ld. AO and the computation made by the Ld.AO suffers from factual inaccuracies. Therefore„ the Ld. AO is directed to restrict the disallowances to the extent offered by the appellant i.e. ₹1,05,54,142/- only. .This ground of addition is thus allowed in. favour of the appellant."

4.3.3 In view of the fact that the learned CIT(A) has not addressed the assessee's claim made before him that the disallowance under section 14A r.w. rule 8D ought to be not more than ₹9,46,325/-, after having noted the assessee's averments in this regard at paras 2.2.2 to 2.2.6, we are of the view that it would not be appropriate for us to adjudicate on the merits of the disallowance under section 14A w.r. rule 8D in the impugned order at this stage, without having the assessee's claim addressed by the learned CIT(A)/AO. In this factual matrix of the case we are of the opinion that the best interest of justice would be served if the issue of the disallowance under section 14A r.w. rule 8D be set aside to the file of the learned CIT(A) to be reconsidered afresh and also in the light of the unaddressed claim of the assessee that the same should be restricted to ₹9,46,325/-. Needless to add that the assessee be afforded adequate opportunity of being heard and to file details/submissions in this regard and also to the AO for rebuttal of the same. It is accordingly ordered. Consequently, ground (i) and (ii) of Revenue appeal and ground No. 1 of the assessee's appeal are treated as allowed for statistical purposes.

5. **Ground No. (iii) of Revenue's appeal – Expenditure on Advertisement Film**

5.1 In this ground, Revenue contends that the learned CIT(A) has erred in treating the expenditure incurred for advertisement films as revenue in nature without appreciating that the assessee becomes owner of the advertisement films which are reusable over an indefinite period of time and gives enduring benefit to the assessee. The learned D.R. was heard and placed strong reliance on the finding in the order of the AO on this

issue in holding the said expenditure to be capital in nature and allowing depreciation thereon.

5.2 Per contra, the learned A.R. of the assessee supported the finding of the learned CIT(A) that the expenditure of ₹70,50,500/- incurred on short commercial advertisement film as revenue in nature. It is submitted that the learned CIT(A) correctly followed the decision of the Hon'ble Bombay High Court in the case of CIT vs. Geoffrey Manners and Co. Ltd. (2009) 315 ITR 134 (Bom) wherein the decision in the case of Patel International Films Ltd. (102 ITR 219) relied on by the AO has been distinguished by the Hon'ble Bombay High Court.

5.3.1 We have heard the rival contentions and perused and carefully considered the material on record including the judicial pronouncements cited. The facts of the matter as emanate from the record are that in the course of assessment proceedings the AO observed that the assessee had debited an amount of ₹70,50,500/- paid to Bappaditya Roy Pictures towards making a short commercial advertisement film to be shown on television, claiming the same to be revenue in nature. The assessee's explanation did not find favour with the AO, who was of the view that such expenses on advertisement/ business promotion is very crucial and the copy of the advertisement film becomes capital asset in the hands of the assessee; is bound to be used repeatedly by the assessee over a long period of time to promote its business, thereby resulting in enduring benefit to the assessee. In that view of the matter, the AO disallowed the assessee's claim and held the expenditure to be capital in nature and allowed depreciation thereon. On appeal, the learned CIT(A) allowed the assessee's claim following the decision of the Hon'ble Bombay High Court in the case of CIT vs. Geoffrey Manners & Co. Ltd. (2009) 315 ITR 134 (Bom).

5.3.2 According to the assessee the above expenditure of ₹70,50,500/- incurred towards making a short commercial advertisement film is a revenue expenditure which did not bring into existence any capital asset or benefit of enduring nature to the assessee. The said expense has made only with respect to its ongoing business and therefore is allowable under

section 37 of the Act. We find that, as in the case on hand, the similar issue was there in the judicial pronouncement relied upon by the assessee, i.e. the case of CIT vs. Geoffery Manners & Co. Ltd. (supra) where the question for consideration before their Lordships of the Hon'ble Bombay High Court was : -

> *"Whether on the facts and circumstances of the case and in law the Hon'ble Tribunal was right in deleting the disallowance made by the Assessing Officer for the expenses incurred by the assessee for promotion films, slide, advertisement films and treating the same as capital expenditure?"*

5.3.3 We find from the facts of the cited case, that as in the case on hand, the assessee there had incurred expenditure on film production by way of advertisement for marketing ongoing products manufactured by them; claiming that these expenses are purely revenue in nature, helping the assessee to make customers aware of its products, which does not result in a capital asset or benefit of enduring nature. In our considered view the assessee's case on this issue is squarely covered by the decision of the Hon'ble Bombay High Court in Geoffrey Manners & Co. Ltd. (2009) 315 ITR 134 (Bom) wherein it is held as under: -

> *"A similar issue had come up for consideration before the Division Bench of the High Court of Punjab and Haryana in CIT v. Liberty Group Marketing Division [2008] 8 DTR 28. In that case the assessee had claimed expenditure incurred on glow sign boards as also T.V. Films, The expenditure was held to be revenue in nature.*
>
> *In our opinion the correct test to be applied in such a case would be, that if the expenditure is in respect of an ongoing business of the assessee and there is no enduring benefit it can be treated as revenue expenditure. If, however, and if it is in respect of business which is yet to commence then the same cannot be treated as revenue expenditure as expenditure is on a product yet to be marketed. Considering the above, in our opinion the judgment in Patel International Film Ltd. (supra) is clearly distinguishable. The Commissioner (Appeals) and the Tribunal on the facts of this case were clearly within their jurisdiction in holding that the expenditure was by way of revenue expenditure as it was in respect of promoting ongoing products of the assessee herein."*

5.3.4 In the aforesaid decision (supra), the Hon'ble Bombay High Court has also distinguished the decision in the case of Patel International Film Ltd. (supra) relied on by the AO. We concur with the observations of the

learned CIT(A) that in today's world where business processes and products change rapidly, it cannot be said that any advertisement expenditure incurred by the assessee will be long lasting as most advertisement films have a short life. Most leading brands in different business keep on changing their advertisements from time to time based on the popularity of their brand ambassadors. In this factual matrix of the case on hand as discussed from para 5.1 to 5.3.3 of this order (supra), and respectfully following the decision of the Hon'ble Bombay High Court in the case of Geoffrey Manners & Co. Ltd. (supra) which applies squarely to the facts of the assessee in the case on hand, we uphold the order of the learned CIT(A) in holding that the said expenditure incurred by the assessee on making of short commercial advertisement film to be revenue in nature. Consequently, ground No. (iii) of Revenue's appeal is dismissed.

6. In the result, Revenue's appeal for A.Y. 2008-09 is treated as partly allowed for statistical purposes and the assessee's cross appeal is treated as allowed for statistical purposes as indicated above.

Order pronounced in the open court on 18th November, 2016.

Sd/-	Sd/-
(Sandeep Gosain)	**(Jason P. Boaz)**
Judicial Member	**Accountant Member**

Mumbai, Dated: 18th November, 2016

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The CIT(A) -16, Mumbai*
4. *The CIT - 8, Mumbai*
5. *The DR, "F" Bench, ITAT, Mumbai*

By Order

//True Copy//

Assistant Registrar
ITAT, Mumbai Benches, Mumbai

n.p.