

**In the Income-Tax Appellate Tribunal,
Delhi Bench 'B', New Delhi**

**Before : Shri I.C. Sudhir, Judicial Member And
Shri L.P. Sahu, Accountant Member**

**ITA No. 5508/Del./2015
Assessment Year: 2011-12**

The Kangra Co-operative Bank Ltd., Jain Khandelwal & Co., CAs, 510, New Delhi House, 27, Barakhamba Road, New Delhi PAN – AAATT0361M (Appellant)	vs.	ACIT, Circle 62(1) New Delhi. (Respondent)
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Appellant by	Shri S.L. Gupta, C.A.
Respondent by	Shri Padam Singh, Sr. DR

Date of Hearing	23.08.2017
Date of Pronouncement	18.09.2017

ORDER

Per L.P. Sahu, A.M.:

This is an appeal filed by the assessee against the order of ld. CIT(A)-20, New Delhi dated 13.08.2015 for the assessment year 2011-12 on the following grounds :

“1. On the facts and circumstances of the case, the order dated 13.08.2015 passed by the Learned Commissioner of Income Tax (Appeals) - XX New Delhi [CIT- (A)] is bad both in the eyes of law and on facts.

2.(i) On the facts and circumstances of the case, Learned CIT (A) has erred both on facts and in law in confirming the order of the Assessing Officer rejecting the contention of the assessee that the appellant has invested in tax free securities out of their own interest free capital/funds and earned tax free interest

(ii) On the facts and circumstances of the case, Learned CIT (A) has erred both on facts and in law in confirming the order of the Assessing Officer rejecting the contention of the assessee that in the absence of any live nexus between the expenditure incurred and the tax free income not forming part of total income, the assessment is bad in law and as such the assessment is illegal and liable to be quashed so.

3.(i) On the facts and circumstances of the case, learned CIT (A) has erred both on facts and in law in confirming the additions of Rs.25,68,356/- made by AO on account of disallowance of expenses u/s 14A to earn tax free income.

(ii) That the above said additions has been confirmed ignoring the fact that no opportunity was provided to the appellant before making the disallowance.

2. The brief facts of the case are that the assessee is a cooperative Bank registered with Registrar of Cooperative Society with GNCT, Delhi and carrying on business of bank under license from Reserve Bank of India. The main source of income of the assessee bank was from interest on loans and deposits of members, interest on deposits with other banks and other investments. The assessee filed return of income declaring an income of Rs.9,76,04,457/-. The case was selected for scrutiny and statutory notices were issued to the assessee. During the course of scrutiny proceedings, the ld. Assessing Officer observed that the assessee has earned tax free interest of Rs.25,68,356/- which have been received on the investment in tax free bonds. The assessee has invested a sum of Rs.2.00 crores each in 6.8% tax free bonds

of IIFCL on 22.01.2009 and 6% IRFC tax free bonds on 16.02.2010. During the year under consideration, the appellant has not invested any funds and received tax free interest on earlier years investment of Rs.13.70 lacs and Rs.11,98,356/- on IIFCL bonds and IRFC bonds respectively and claimed both as tax free interest u/s. 10. The Assessing Officer applying section 14A read with Rule 8D and assumed that main business activities is banking and includes investment of funds thereby earning interest income, the same is not possible without incurring expenditure in order to invest and manage the investment regularly. Therefore, the assessee must have incurred certain expenditure towards earning of exempted income. He also noted that the assessee has suo moto has not disallowed any expenditure to earn the tax free income. The basis of disallowance made by the Assessing Officer is as under :

“The assessee has not made any disallowance on its own in spite of the fact that it has incurred some portion of its overall expenditure for the investment resulting in tax free income. In view of the fact that the assessee is a banking concern having huge investments and major expenditure on account of interest and as the total exempt income is only Rs.25,68,356/- hence the disallowance u/s. 14A is restricted to the said amount.”

Aggrieved by the order of the AO, the assessee appealed before the first appellate authority, who after considering the submissions of the assessee, confirmed the action of the Assessing Officer. Aggrieved by the order of Id. CIT(A), the assessee has filed this appeal before the Tribunal.

3. The Id. AR submitted a small synopsis, relying on some case laws, which read as under :

“The appellant has invested a sum of Rs. Two Crore each, in 6.85% tax free bonds of IIFCL on 22.01.2009 and 6.00% IRFC tax free Bonds on 16.02.2010. During the year under appeal the appellant has not invested any funds and received tax free interest (On earlier years investments) of Rs.13.70 Lac & Rs.11,98,356/- Lac on IIFCL Bonds and IRFC Bonds respectively and claimed both as tax free interest u/s 10.

The appellant bank is a financial institution duly licensed by the Reserve Bank of India, borrowing of funds and lending of funds is its main business. Funds invested by the public are sanctioned/ disbursed to its members in the shape of various types of short term/long term loans and surplus funds are time to time invested with other financial institutions in the shape of short term/long term as per the prudential norms of the RBI for investments of funds. Investment in Bonds and securities etc. is part of the working capital of the appellant.

The appellant has not incurred any expenditure, of what so ever natures, on the investment of captioned tax free bonds and receipt of interest thereon. The merchant bankers collected the application from the office of the appellant and interest is directly credited to their bank account through RTGS/NEFT. There are no direct or indirect administrative expenses of what so ever nature against the receipt of this tax free interest

The appellant has invested in the Tax Free Bonds from its own interest free funds and its working capital only and there is no nexus between the expenditure incurred and the tax free income not forming part of total income. The appellant has invested a sum of Rs. 400.00 Lac in the Tax Free Bonds from its own interest free capital/funds, duly reflected in the audited annual accounts, in the shape of share money and other earned/retained earnings/free reserves. Copy of audited accounts for the year ended on 31.03.2009, 31.03.2010 and 31.03.2011 are hereby enclosed. Comparative detail of appellant's own funds is as follows:

Particulars	(Amount in Rs. Lac)		
	as on 31.03.2009	as on 31.03.2010	as on 31.03.2011
Investment in Tax free Bonds	200.00	400.00	400.00
Share Capital	1303.03	1657.20	1843.82
Reserves & Profits	3037.01	3262.66	3708.62
Total own funds	4340.04	4919.86	5552.44

The Assessing Officer has failed to verify the correctness of the appellant's claim having regard to the accounts of the appellant. The Assessing Officer has not given any cogent reason in the assessment order for disbelieving the contention of the appellant that it has incurred no expenditure to earn the exempt income. The Assessing Officer has not examined the accounts of the appellant and there is no satisfaction recorded

by the Assessing Officer about the correctness of the claim of the appellant and without application of independent mind disallowance u/s 14A has been made.

The Assessing Officer has just made the arbitrary disallowance and added to the income u/s 14A and failed to mention how the disallowance under Rule 8D has been calculated.

The AO has not brought on record anything which proves that there is any expenditure incurred towards earning of tax free income. The AO has not examined the accounts of the appellant and there is no satisfaction recorded by the AO about the correctness of the claim of the appellant. While rejecting the claim of the appellant with regard to expenditure or no expenditure, as the case may be, in relation to exempted income, the AO has not indicated any cogent reasons for the same. The AO has not considered the claim of the appellant and straight away added whole of the tax free income received by the appellant

In view of the various pronouncements of the various courts including the jurisdictional courts, there is no disallowance u/s 14A/rule 8D on this exempt income and the following case laws directly supports the contention of the appellant, that when the appellant has invested from its own interest free funds and also there is no nexus between the expenditure not directly connected with the exempt income, disallowance u/s 14A is ruled out.

a). *In the case of Delhi Towers Ltd. v. DCIT (2017) 163 ITD 124, (A/Y 2009-10) the ITAT Delhi has held:*

On facts, there was no fresh investment made by assessee during year under consideration and tax free dividend income had been earned from old investments, disallowance made by Assessing Officer was directed to be deleted.

b). *The Hon'ble Delhi High Court in the case of Maxopp Investments Ltd. V. CIT [2011 (11)TMI 267 has held:*

That by virtue of the provisions of Section 14A(2) & 14A(3) of the Act, if the Assessing Officer is not satisfied by the correctness of the claim of the assessee in respect of such expenditure or no expenditure, as the case may be, cannot embark upon the determination of the amount of expenditure in accordance with Rule 8D. While rejecting the claim of the assessee, the Assessing Officer has to render cogent reasons for the same. In a case where the assessee states that no expenditure has been incurred by it to earn exempt income, the Assessing Officer has to verify the correctness of the assessee's claim having regard to the accounts of the assessee. In the case on hand, we find that the Assessing Officer has not given any cogent reason in the order of assessment for disbelieving the contention of the assessee that it has incurred no expenditure to earn the exempt income of Rs.18,400/- but has proceeded to apply the provisions of Rule 8D to arrive at the disallowance of Rs.1,93,730/- as the expenditure deemed to be incurred for earning exempt income. Thus we delete the disallowance of Rs.1,93,730/- made by the Assessing Officer u/s 14A w. Rule 8D."

c) *In the case of M/s Minda Capital Ltd. vs DCIT, (ITA No. 568/Del/2013 dated 25.03.2015 the ITAT Delhi has held as under:*

In the case, the A.O. vide questionnaire dated 22.10.2010 had asked the assessee to explain as to why disallowance in accordance with the provisions of Section 14A should not be made and thereafter holding that reply of the assessee was not satisfactory he proceeded to disallow the amount as calculated as per provisions of Rule 8D. The A.O. did not record as to how the explanation submitted by assessee was not satisfactory. The A.O. should have examined the claim of assessee and then he should have recorded his satisfaction as to why the reply of assessee was unsatisfactory. Therefore, respectfully following the order of Hon'ble High Court in the case of Taikisha Engineering India Ltd. we delete the disallowance confirmed by Ld. CIT(A).

d) *In case of Modern Info Technology P. Ltd. Vs. ITO (ITA NO. 4294/Del/2012) a/y 2009-10 the Hon'ble ITAT, BENCH 'E1 DELHI has categorically stated that:*

- Disallowance u/s 14A cannot be made if appellant has not incurred & claimed any expenditure against exempt income*
- To disallow the expenditure u/s 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."*

e) *In case of CIT v. Oriental Structural Engineers (P) Ltd. (2013) 216 Taxman 92 (Mag), The Hon'ble High Court of Delhi has stated that:*

"Expenditure not directly connected with the exempt income cannot be disallowed"

f) *In case of DCIT vs. Ashish Jhunjunwala (ITAT Kolkata) (J. K, Investors (Bombay) followed) AY 2009-10, it was held:*

The AO has not brought on record anything which proves that there is any expenditure incurred towards earning of dividend income. The AO has not examined the accounts of the assessee and there is no satisfaction recorded by the AO about the correctness of the claim of the assessee and without the same he invoked Rule 8D. While rejecting the claim of the assessee with regard to expenditure or no expenditure, as the case may be, in relation to exempted income, the AO has to indicate cogent reasons for the same. The AO has not considered the claim of the assessee and straight away embarked upon computing disallowance u/r 8D. This is not permissible.

g) *In case of DLF Southern Towns Pvt. Ltd. vs. DCIT - (2015) 45 CCH 0028, ITAT Delhi, it was held:*

Where the assessee had not claimed any expenditure for earning exempt income in the Profit and Loss account and the AO had not recorded any satisfaction as to why he was not satisfied with the claim of the assessee that no expenses were incurred for exempt income, no disallowance could be made u/s 14A of the Act

h). In case of CIT v. REI Agro Ltd. (CHC), (ITA No. 161 of 2013, dt 23/12/2013.) www.itatonline.org, (AY.2009-10) it was held:

The AO disallowed the expenditure u/s 14A without first recording that he was not satisfied with the correctness of the claim as regards the claim that "no expenditure" was made by the assessee. The disallowance u/s 14A of the Income-tax Act, 1961 is plainly contrary to the provisions of the statute. The CIT allowed the appeal of the assessee and the Tribunal did not interfere. Challenging the order of the tribunal, the present appeal has been filed. We are of the opinion that no point of law has been raised. Therefore, this appeal is dismissed.

i) In case of CIT v. Glenmark Pharmaceutical Ltd. (2013) 351 ITR 359/ 85 DTR 169 the Hon'ble Bombay High Court has stated that

"Where no expenditure was incurred for earning exempt income, disallowance u/s 14A cannot be made"

j) In the case of Fereshte Sethna (Ms) v. ACIT (2017) 162 ITD 412 A/Y 2010-11, the ITAT Mumbai has held:

Allowing the appeal of the assessee, the Tribunal held that AO cannot directly invoke rule 8D for making disallowance without examining the claim of the assessee.

The disallowance u/s 14A could not be made unless a satisfaction was reached by the AO that the appellant's claim could not be accepted having regard to the accounts. No such satisfaction having been recorded by the AO. The Assessing Officer has not recorded any cogent reasons for rejecting the claim of the appellant that no expenses were incurred to claim exempt income. The additions, for whole of the interest received during the year under appeal, amounting to Rs. 25,68,356/- on the investments made in prior periods, u/s 14A is liable to be deleted.

The appellant prays that the additions of Rs. 25,68,356/- u/s 14A made by the AO be deleted.

Deduction u/s 36(1)(viiia)

The Ld. Assessing Officer on the basis of hypothetical assumptions assessed the income of the appellant on the enhanced income against the returned income and ALTERNATIVELY not allowed the deduction of 7.5% on the enhanced assessed income

u/s 36(1)(viii) of the Income Tax Act, 1961. Deduction u/s 36(1)(viii) is allowed on the basis of returned taxable income.”

4. On the other hand, the ld. DR relied on the order of lower authorities and submitted that without incurring expenditure, income cannot be earned by the assessee. The assessee has also not disallowed any expenditure. The assessee is a banking company and earning interest on its investment, therefore, the Assessing Officer has disallowed to the extent of Rs.25,68,356/- received as exempted interest income.

5. After hearing both the parties and perusing the material available on record, we find that the appellant has not made any fresh investment during the year. He has received interest only on the investments made in earlier years. The appellant is engaged in the banking business activities. The investments held by the banking concerns are treated as a part of its business income. Therefore, income arising from such investments is treated as part of business income falling under the head profit and gains of business. The appellant contended that no expenditure was incurred for earning above exempt income which does not form part of the total income. The Assessing Officer has disallowed total exempted interest earned without any basis. It is undisputed fact that the assessee company has earned tax exempt income. The provisions of section 14A states that no deduction shall be allowed in

respect of expenditure incurred by the assessee in relation to income, which does not form part of the total income under the Act. The AO has not given any finding as to how the claim of the assessee bank that no expenditure was incurred to earn exempt income was incorrect. Furthermore, it is undisputed fact that exempt income is earned from securities, which were invested in the earlier years. No any fresh investments have been made. The case laws relied by the assessee are squarely applicable to the present case. In view of the above, the appeal of the assessee is found to have merit and deserves to be allowed.

6. In the result, the appeal is allowed.

Order pronounced in the open court on 18.09.2017.

Sd/-
(I.C. Sudhir)
Judicial member

Sd/-
(L.P. Sahu)
Accountant Member

Dated: 18.09.2017

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Copy of order forwarded to:

<i>(1) The appellant</i>	<i>(2) The respondent</i>
<i>(3) Commissioner</i>	<i>(4) CIT(A)</i>
<i>(5) Departmental Representative</i>	<i>(6) Guard File</i>

By order

Assistant Registrar
Income Tax Appellate Tribunal
Delhi Benches, New Delhi