INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "E": NEW DELHI
BEFORE SHRI H.S.SIDHU, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No. 198 & 199/Del/2016
(Assessment Year: 2011-12 & 2012-13)

Simon India Ltd, Mehtab, A-36, Ground Floor, Mohan Co-op, Industrial Estate, New Delhi PAN: AAECS5013J	Vs.	DCIT, Circle-8(1), New Delhi
(Appellant)		(Respondent)

Assessee by :	Shri K.V.SR Krishna, CA
Revenue by:	Ms. Pramita M Biswas, CIT DR
Date of Hearing	09/01//2019
Date of pronouncement	21/02/2019

O R D E R

PER PRASHANT MAHARISHI, A. M.

1. These two appeals filed by the assessee for different Assessment Years 2011-12 and 2012-13 against the order of the ld CIT(A)-28, New Delhi [The Ld CIT (A)] both dated 24.11.2015 .

2. The assessee has raised the following grounds of appeal In ITA No. 198/Del/2016 for the Assessment Year 2011-12:-

"*1. The Ld. CIT(A) has erred in law and on facts in confirming the disallowance of Rs. 39,34,312/- made u/s 14A read with Rule 8D of the Income Tax Rules, 1962. The disallowance is wrong and bad in law and deserves to be deleted.*

2. The appellant contends that no expenditure has been incurred for earning the tax: free income. The Ld. CIT(A) as well as AO has not. found any expenditure having incurred for earning the tax free income as is evident on examination of books and vouchers. No such nexus has been established. Hence, the disallowance u/s 14A should be made.

3. The explanation given by the appellant has been brushed aside. The AO has applied Rule 8D mechanically without establishing any nexus between the expenditure and the tax free income. The Ld. CIT(A) has simply confirmed the AO's order. Therefore there is no case for making any disallowance u/s 14A by mechanically applying Rule 8D. Hence the addition should be deleted.

4. *The Ld. CIT(A) has erred in law and on facts in upholding the disallowance of Rs. 9,48,55,236/- in respect of warranty expenses made by AC). The disallowance is without any basis and hence deserves to be deleted.*

5. *The appellant contends that the entire claim of warranty provision is emanating from the terms of the contract, it is a contractual obligation and therefore the provisions should be allowed in full as claimed. The CIT(A) as well as AO having accepted the existence of risk provision, should not have restricted the claim to 4.69% of the contract value. The sum of Rs. 9,48,55,236/- should also be allowed to the assessee.*

6. *The appellant contends that the provision towards liability is made by the company considering the nature of business, nature of the product and the risk involved in such project. Therefore such risk provision is based on scientific working and should be allowed as it is contractual obligation.*

7. *The appellant further contends that the CIT(A) or AO has not brought any material for alleging excess claim of risk provision. The AO has only made an arithmetical working and arrived at a simple average of earlier years risk provisions, that too, in respect of contracts which are not at all comparable with the contract under consideration. Hence, there is no basis for making the disallowance of Rs. 9,48,55,236/- and has to be deleted.*

8. *Without prejudice, the appellant submits that the above addition will result in double taxation as out of total provision of Rs. 36,03,40,221/-, Rs. 23,45,73,018/- has been reversed by the appellant in subsequent years and offered for tax. This fact is mentioned by Ld. CUT (A) in its order Therefore also, the addition made of Rs. 9,48,55,326/- deserves to be deleted.*

9. *The above grounds are independent and without prejudice to one another.*"

3. The assessee has raised the following grounds of appeal In ITA No. 199/Del/2016 for the Assessment Year 2012-13:-

"*1. The Ld. CIT(A) has erred in law and on facts in confirming the disallowance of Rs. 45,77,189/- made u/s 14A read with Rule 8D of the Income Tax Rules, 1962. The disallowance is wrong and bad in law and deserves to be deleted.*

2. *The appellant contends that no expenditure has been incurred for earning the tax: free income. The Ld. CIT(A) as well as AO has not. found any expenditure having incurred for earning the tax free income as is evident on examination of books and vouchers. No such nexus has been established. Hence the disallowance u/s 14A should be made.*

3. *The explanation given by the appellant has been brushed aside. The AO has applied Rule 8D mechanically without establishing any nexus between the expenditure and the tax: free income. The Ld. CIT(A) has simply confirmed the AO's order. Therefore there is no case for making any disallowance u/s 14A by mechanically applying Rule 8D. Hence the addition should be deleted.*

4. *The Ld. CIT(A) has erred in law and on facts in upholding the disallowance of Rs. 37,81,200/- in respect of warranty expenses made by AC). The disallowance is without any basis and hence deserves to be deleted.*

5. *The appellant contends that the entire claim of warranty provision is emanating from the terms of the contract, it is a contractual obligation and therefore the provisions should be allowed in full as claimed. The CIT(A) as well as AO having accepted the existence of risk provision, should not have restricted the claim to 4.69% of the contract value. The sum of Rs. 37,81,200/- should also be allowed to the assessee.*

6. *The appellant contends that the provision towards liability is made by the company considering the nature of business, nature of the product and the risk involved in such project. Therefore such risk provision is based on scientific working and should be allowed as it is contractual obligation.*

7. *The appellant further contends that the CIT(A) or AO has not brought any material for alleging excess claim of risk provision. The AO has only made an arithmetical working and arrived at a simple average of earlier years risk provisions, that too, in respect of contracts which are not at all comparable with the contract under consideration. Hence, there is no basis for making the disallowance of Rs. 37,81,200/- and has to be deleted.*

8. *Without prejudice, the appellant submits that the above addition will result in double taxation as the unutilized provisions, if any, has been reversed by the appellant in subsequent years and offered for tax. This fact is mentioned by the ld CIT(A) in its order. Therefore also the addition made of Rs. 37,81,200/- deserves to be deleted.*

9. *The above grounds are independent and without prejudice to one another.*"

4. Coming first to the appeal for AY 2011-12, brief facts of the case is that the assessee is a company who filed its return of income on 28.09.2011 declaring income of Rs. 34,88,48,820/-. During the year the assessee has earned dividend income of Rs. 3,78,72,745/-. Such dividend income is exempt and therefore, the ld AO asked the assessee to explain why section 14A should not be applied. Therefore, the assessee explained vide letter dated 30.08.2013 that the assessee has not incurred any expenditure for earning this income and therefore, there is no disallowance. The ld AO thereafter straightway applied the provisions of Rule 8D and made disallowance of Rs. 4518653/- section 14A read with Rule 8D against which the assessee preferred an appeal before the ld CIT(A) who upheld the disallowance under Rule 8D(2)(iii) of Rs. 3934312/- and deleted the disallowance of Rs. 584341/-, therefore, the assessee is in appeal before us.

5. Before us, the ld AR submitted that the assessee has not incurred any expenditure for earning the exempt income. It is further stated that the ld AO is without recording any satisfaction about the correctness of the claim of the assessee of not incurring any expenditure, he applied the provisions of Rule 8D of the Income Tax Rules, 1962. He submitted that same is not acceptable. Even otherwise he stated that on the identical facts and circumstances in case of the assessee for Assessment Year 2009-10 and 2010-11 the coordinate bench is upheld ad hoc disallowance of Rs. 1 lakh and Rs. 3.5 lakhs in those years. This year he stated that in absence of any satisfaction, no disallowance can be made. The assessee also relied upon the several decisions to state that absence of satisfaction, disallowance cannot be made.

6. The ld DR submitted that the assessee has earned huge dividend income and therefore, it cannot be stated that the assessee has not incurred any expenditure. He further stated that the order of the ld AO shows proper satisfaction as assessee has incurred interest expenditure etc in its profit and loss account.

7. We have carefully considered the rival contentions and also perused the orders of the lower authorities. In the present case the assessee has earned exempt income however, it claimed before the ld AO that it has not earned any expenditure for the purpose of earning exempt income. Without rejecting the explanation of the assessee, on verification of the books of account of the assessee, the ld AO applied the provision of Rule 8D and made the disallowance. The Hon'ble Supreme Court in Maxopp Investment Ltd. Vs. CIT 402 ITR 560 in para 42 has specifically held that before applying the theory of apportionment the ld AO need to record satisfaction about the stand on disallowance of the assessee. Therefore as ld AO has not recorded any satisfaction about the correctness of claim of that assessee that it has not incurred any expenditure for earning of exempt income, we are not inclined to uphold any disallowance u/s 14A of the act. In view of this we allow the ground No. 1 to 3 of the appeal of the assessee and direct the ld AO to delete the disallowance of Rs. 3934312/- made u/s 14A read with Rule 8D of the Rules.

8. The second issue of the appeal is with respect to disallowance of warranty expenditure of Rs. 94855236/-. The assessee is claiming project expenditure of Rs. 105.48 crores which contained warranty risk expenses provision examined by the ld AO. The assessee explained that the above expenditure is on account to risk assessment provision of warranties. The ld AO noted that the major provision pertaining to project in Saudi Arabia and more than 90% of the project has been completed therefore, the excess provision claimed by the assessee is required to be restricted. The ld AO examined the claim of the assessee and also the year wise provision and the claim he stated that as per the details submitted the percentage of provision relying to risk is 6.42% of the contract value of Rs. 5484.29 crores whereas according to him such percentage is very high and the past average goes to Rs. 4.69%. He disallowed 1.73% of the contract value as excess provision for the warranties and disallowed Rs. 94855236/-. The assessee aggrieved with the order of the ld AO referred appeal before the ld CIT(A) who vide para 5.1 to 5.3 confirmed the above disallowances. However, he stated that there is no reason to doubt the manner of working of the warranty claimed by the assessee but the estimate made by the ld AO is reasonable. The assessee aggrieved by the order of the ld AO has preferred appeal before us.

9. The ld AR submitted that identical issues in assessee's own case for Assessment Year 2004-05 has been considered by the coordinate bench and same was allowed by the coordinate bench for that year. Even otherwise, he submitted that the assessee is carrying out the project work in Saudi Arabia on the contract for such work he has placed at page No. 50 to 113 of the paper book. He also referred to the provision made of the warranty at page No. 48 and 49 of the paper book and submitted that the movement of the warranty charges placed at page No. 114 of the paper book starting from Assessment Year 2011-12 to 2015-16 shows that whenever the warranty is not materilising this reference and offered for taxation. He therefore, submitted that when the assessee is following a method which is scientific and quantification is also periodical measure and adjusted on year to year basis. There is no justification for AO to restrict it at 4.62% without any basis.

10. The ld DR vehemently submitted that the ld AO give a detailed reason which shows that warranty provision is 6.42% in one contract and 4.33% in another contract. He therefore, submitted that disallowance of warranty of provision of 1.73% deserves to be upheld.

11. We have carefully considered the rival contentions and also perused the orders of the lower authorities. The assessee has made a provision for warranty expenditure and given a detailed working of such risk provision. Looking at the working of the warranty it is found that the assessee is executing the project in Saudi Arabia for the purpose of estimation of risk the assessee has bifurcated the same into supply risk, construction risk, commercial risk, execution risk and man hour risk. Based on this the assessee made a provision for the warranties. The ld AO accepted the claim of the assessee on the principle of the risk, however exempt the claim of the assessee form FY 2001-02 onwards and thus stated that that assessee for this year has claimed 6.42% is higher compared to historical trends and therefore, he calculated simple average by adding by the percentage and reached at the average 4.69% and thus disallowed 1.73% of the contract value. Same was also confirmed by the ld CIT(A). on examination of the assessee we find that the claim made by the assessee is prejudicial and risk wise. The above claim was also made after converting in applying year end rate of foreign exchange and also reducing it that back to back warranty available from vendors. However it is also apparent that whenever the warranty provisions were no longer require the same was also reversed in accordance with the accounting standard 28 issued by ICAI. The approach of the ld AO in taking the past history of the percentage and considering the simple average of the same is not acceptable for the reason that the business risk changes with each of the contract and also it does not remain similar ever year. Even otherwise merely applying the law of average to the accounting estimate is not a correct approach. Accordingly, we direct the ld AO to delete the disallowance on account of warranty expenditure of Rs. 94855236/-. Accordingly ground No. 4 to 7 of the appeal are allowed.

12. Because of our decision of the above ground No. 8 becomes infractuous.

13. Accordingly, appeal of the assessee for Assessment Year 2011-12 is partly allowed.

14. Now we come to the appeal of the assessee for Assessment Year 2012-13.

15. Ground No. 1 to 3 relates to disallowance to Rs. 4577189/- u/s 14A read with Rule 8D of the Income Tax Act, 1961 and Ground Nos. 4 to 7 are with respect to warranty provision disallowed by the ld AO of Rs. 3781200/-. Coming to disallowances u/s 14A the assessee has earned dividend of Rs. 64890813/- it is exempt from taxes. On question the assessee submitted vide letter dated 03.12.2014 that it has not incurred any expenditure. In the present case the ld AO recorded his satisfaction stating that administrative expenditure and interest expenditure have been incurred by the assessee in this process of investment and there is direct and proximate nexus between expenditure incurred and exempt income and therefore, Rule 8D applies. Accordingly, disallowances of Rs. 4596971/- was made. On appeal before the ld CIT(A) the disallowance was restricted to Rs. 4577189/- against which the assessee is in appeal before us.

16. The ld AR submitted that there is no satisfaction recorded by the ld AO. He referred to the decision of the Hon'ble Delhi High Court in 399 ITR 576. In view of this same should be acceptable.

17. The ld DR submitted that Rule 8D has been applied by the ld AO after recording satisfaction in a proper manner. Therefore, there is no escapement of the disallowance made by the ld AO and confirmed by the ld CIT(A). The ld DR relied upon the decision of the Hon'ble Supreme Court in case of Maxopp Invesmtent Ltd Vs CIT and Hon’ble Punjab and Haryana High Court in case of Punjab Tractors Ltd.

18. We have carefully considered the rival contentions and perused the orders of the lower authorities. During the year the assessee has received the exempt income in the form of dividend of INR 6 4890813/–. The assessee was asked to explain why disallowance u/s 14 A not be made against the exempt income of the assessee. The assessee has not disallowed any expenditure towards earning of the exempt income. The assessee vide letter dated 3/12/2014 has also stated that no expenses have been incurred by the assessee in earning this income and therefore no disallowance has been made. The learned AO noted that indirect cost in the form of administrative expenditure and interest has been incurred in this process of investment and there is a direct and proximate nexus between the exempt income

which the investment shall generate and therefore the expenditure is directly or indirectly involved in earning the said income therefore the learned assessing officer invoked the provisions of rule 8D worked out disallowance of expenditure under section 14 A of the act. The only issue is whether the proper satisfaction has been recorded by the learned assessing officer in terms of the provisions of section 14 A (2) of the income tax act or not. On the identical facts and circumstances the honourable Delhi High Court in HT media Ltd vs principal Commissioner of income tax 399 ITR 576 (Del) on the issue of failure of the learned assessing officer to record a proper satisfaction has held as under:-

> "Failure of the AO to record satisfaction
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> **32.** The question regarding the failure of the AO to record his dissatisfaction with the correctness of the Assessee's claim regarding administrative expenses of Rs. 3 lakhs arises in ITA 349 of 2015. Mr Raghvendra Singh is not entirely right in his submission that there is no question framed about the failure by the AO to record his satisfaction. In ITA 349 of 2015, the question framed by this Court by the order dated 15th October 2015 is in fact in two parts: viz., (i) Whether the AO recorded a proper satisfaction in terms of Section 14A (2) and Rule 8 (D) of the Rules and (ii) in calculating the disallowance at 0.5% of average value of investments as per clause (iii) of Rule 8 D (2) of the Rules?
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> **33.** The contention of Mr. Singh is that if there was a valid recording of satisfaction by the AO as required by Rule 8D (1), then there was no option available to the AO other than to apply Rule 8D (2) of the Rules. Therefore, even according to the Revenue, the applicability of Rule 8D (2) hinges on the recording of the AO in terms of Rule 8D (1) that he was not satisfied with the Assessee's claim regarding expenditure incurred to earn the exempt income.
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> **34.** The Assessee had explained that Rs. 3 lakhs was being disallowed voluntarily as an "expenditure which could be attributable for earning the said income." The Assessee explained that the disallowance had been determined on the basis of cost of finance department in the ratio of exempt income to total turnover. On that basis the disallowance in AY 2005-06 was upheld by CIT (A) at Rs. 1 lakh. The disallowance for this AY was worked out as Rs. 1,42,404/- and since the Assessee had already made a disallowance of Rs. 3 Lacs, no further disallowance was called for.
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> **35.** In order to disallow this expense the AO had to first record, on examining the accounts, that he was not satisfied with the correctness of the Assessee's claim of Rs. 3 lakhs being the administrative expenses. This was mandatorily necessitated by Section 14 A (2) of the Act read with Rule 8D (1) (a) of the Rules.
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> **36.** In para 3.2 of the assessment order, the AO records that, in answer to the query posed by the AO requiring it to produce calculation for disallowances, the Assessee "submitted that they have not incurred any expenditure for earning the dividend income." Thereafter, in para 3.3, the AO records "I have

considered the submissions of the Assessee and found not to be acceptable." Thereafter, the AO proceeded to deal with the said provisions of Section 14A and Rule 8D and observed, in para 3.3.1, that making of investment, maintaining or continuing investment and time of exit from investment are well informed and well coordinated management decisions that, in relation to earning of income, are embedded in indirect expenses. It is then stated in para 3.4 that, in view of the above, the provisions of sub-section (2) of Section 14A and Rule 8D of the Rules are in operation and therefore, will strictly be adhered to by the Assessee. In para 3.6 of the assessment order, after discussing Section 14A(1) read with Rule 8D and referring to the decision of the Bombay High Court in Godrej and Boyce Mfg. Co. Ltd. (supra), the AO simply stated that "in view of the facts and circumstances and legal position on the issue as discussed above, I am satisfied that the Assessee had incurred expenses to manage its investments which may yield exempt income, and Assessee grossly failed to calculate such expenses in a reasonable manner to ascertain to ascertain the true and correct picture of its income and expenses."

37. In the considered view of this Court, the above observations of the AO in the assessment order are of a broad general nature not with particular reference to the facts of the case on hand.

38. The Court is also unable to agree with Mr. Singh that on this aspect there are concurrent findings of both the CIT (A) as well as the ITAT. The CIT (A) disallowed the exempt expenses by merely repeating what the AO had stated about the cost that is built into so called 'passive' investments and simply recorded that the AO was bound to Rule 8D and, therefore, was justified in determining administrative costs at 0.5%. Here again, the CIT (A) failed to note that without the mandatory requirement, under Section 14A of the Act and Rule 8D of the Rules, of satisfaction being recorded being met, the question of applying Rule 8D (1) did not arise.

39. Turning now to the order of the ITAT, in para 33, it recorded the submission of the AR that the AO did not record any satisfaction about the Assessee not properly offering expenditure incurred in relation to the exempt income at Rs. 3 lakhs. The ITAT reproduced the contents of para 3.3.1 of the assessment order, which has been extracted by this Court hereinbefore, which contains general observations regarding earning of exempt income. This cannot be accepted as a recording by the AO of satisfaction regarding the claim of the Assessee after examining its accounts. Again, in para 34 of its order, the ITAT simply reproduced para 3.3.6 of the assessment order where, again, no reasons have been provided but only a conclusion has been reached that the AO was "satisfied that the Assessee had incurred expenses to manage its investments which may yield exempt income, and Assessee grossly failed to calculate such expenses in a reasonable manner to ascertain the true and correct picture of its income and expenses."

40. Consequently on the aspect of administrative expenses being disallowed, since there was a failure by the AO to comply with the mandatory requirement of Section 14 A (2) of the Act read with Rule 8D (1) (a) of the Rules and record his satisfaction as required thereunder, the question of applying Rule 8D (2) (iii) of the Rules did not arise. The question framed in ITA 549 of 2015 is answered accordingly."

19. As stated in the above order the learned assessing officer recorded the general observation regarding earning of exempt income. The honourable Delhi high court further held that this cannot be accepted as a recording of the assessing officer of satisfaction regarding the claim of the assessee after examining its accounts. Apparently in this case also the learned assessing officer has reached at the conclusion without recording the satisfaction on examination of books of accounts. Accordingly the issue is squarely covered by the decision of the honourable Delhi High Court. Hence, respectfully following the same, reversing the order of the lower authorities, we direct the learned assessing officer to delete the disallowance u/s 14 A of the income tax act. Accordingly ground number 1-3 of the appeal of the assessee is allowed.

20. Ground No. 4 to 7 are relating to the disallowances of royalty expenditure which has been dealt by us in appeal for Assessment Year 2011-12 deleting the disallowance. Therefore, for the same reason we delete the disallowance of Rs. 3781200/- made for Assessment Year 2012-13 on the same reasoning, accordingly, ground Nos. 4 to 7 are allowed.

21. Ground No. 8 because of our decision in ground No. 4 to 7 is infractuous and hence same are dismissed.

22. Accordingly appeal for Assessment Year 2012-13 is partly allowed.

Order pronounced in the open court on 21/02/2019.

-Sd/-	-Sd/-
(H.S.SIDHU) JUDICIAL MEMBER	(PRASHANT MAHARISHI) ACCOUNTANT MEMBER

Dated:21/02/2019
A K Keot

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi