

**IN THE INCOME TAX APPELLATE TRIBUNAL
DIVISION BENCH 'B', CHANDIGARH**

BEFORE SHRI SANJAY GARG, JUDICIAL MEMBER
AND SMT. ANNAPURNA GUPTA, ACCOUNTANT MEMBER

ITA No. 407/Chandi/2018

(Assessment Year: 2014-15)

DCIT Circle- 1, Ludhiana	Vs.	M/s Vardhman Special Steels Ltd Vardhman Premises, Chandigarh Road, Ludhiana PAN No. – AADCV4812B
Appellant		Respondent

ITA No. 350/Chandi/2018

(Assessment Year: 2014-15)

M/s Vardhman Special Steels Ltd Vardhman Premises, Chandigarh Road, Ludhiana PAN No. – AADCV4812B	Vs.	DCIT Circle- 1, Ludhiana
Appellant		Respondent

Department by : Shri. G.S. Phani Kishor, CIT(DR)
Assessee by : Shri. Vineet Jain, Adv.

Date of hearing : 20/03/2019
Date of Pronouncement : 04/04/2019

ORDER

PER ANNAPURNA GUPTA, ACCOUNTANT MEMBER:

The above cross appeals are filed by the assessee and Revenue against the order passed by the Commissioner of Income Tax (Appeals)-1, Ludhiana [in short referred as CIT(A)] u/s 250(6) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') dated 30-01-2018.

2. The Assessee has raised the following grounds in its appeal in ITA No. 350/Chandi/2018 :

1. *That the Order passed by the Ld.CIT(A) is contrary to law and facts of the case.*
2. *That the Ld.CIT(A) erred in law and on facts in upholding the applicability of Rule 8D and making disallowance thereunder.*
3. *That the Ld. CIT(A) erred in law and on facts in applying amended provisions of Rule 8D which were effective from 02.06.2016.*
4. *That the appellant craves leave to add/alter/amend any ground of appeal on or before the due date of hearing of appeal.*

(3) The sole issue raised by the assessee in its appeal relates to disallowance of expenses made u/s 14A of the Act pertaining to those incurred for the purpose of earning exempt income.

(4) Brief facts relating to the issue are that during the impugned year the assessee company had earned exempt income (from holding of investments) for which there was a voluntary and suo-motu disallowance of Rs. 2,66,084/- made by the assessee in the computation of income filed along with return of income. Not being satisfied with this voluntary disallowance, the Assessing Officer invoked the machinery provision contained in Rule 8D of the Income Tax Rules, 1962, (hereinafter referred to as "Rules") and worked out the disallowance at Rs. 17,61,949/-. Reducing there from the amount already disallowed by the assessee amounting to Rs. 2,66,084/-, a further disallowance of Rs. 14,95,865/- was made by the AO, of expenses u/s 14A of the Act.

(5) Aggrieved by the same, the assessee went in appeal before the CIT(A) who upheld the action of the AO in making disallowance u/s 14A of the Act r.w Rule 8D of the Rules, but at the same time held that the amount of disallowance was to be calculated as per the amended provisions of Rule 8D which had been made effective from 2nd June, 2016, holding that they were retrospective in application. Accordingly, the Ld. CIT(A) directed the AO to calculate the disallowance of expenses u/s 14A as per the amended provisions of Rule 8D.

(6) Aggrieved by the same the assessee has come in appeal before us challenging the order of the Ld.CIT(A) in upholding the disallowance u/s 14A, the applicability of Rule 8D of the Rules and also the applicability of the amended Rule 8D.

(7) Before us, the Ld. Counsel for the assessee, at the outset, contended that the issue was covered in favour of the assessee by the decision of the ITAT, Chandigarh Bench in the case of the assessee itself in preceding years i.e. assessment year 2013-14 vide their order in ITA No. 1510 & 1518/Chd/2017 dated 20.12.2018 and assessment year 2012-13 in ITA No. 574/Chd/2017 dated 11.12.2017. Ld. Counsel for the assessee further contended that the ITAT had deleted the disallowance made in assessment year 2013-14 on finding that the requisite satisfaction of the AO vis-a-vis the incorrectness of the claim of the assessee of the amount disallowable u/s 14A was absent. Therefore, following the proposition of law laid down by the jurisdictional High Court in the cases of CIT vs. Deepak Mittal, (2014) 361 ITR 131 (P&H) & CIT vs. Abhisek Industries Ltd.,

(2016) 380 ITR 652 (P&H), that the aforesaid satisfaction of the AO was a necessary prerequisite for invoking the machinery provision of Rule 8D, the disallowance made u/s 14A was deleted. Our attention was drawn to the relevant findings of the ITAT at para 12-14 of the order .) Drawing our attention to the said paragraphs, Ld. Counsel for the assessee contended that in the said case it was noted by the ITAT that the assessee had explained the basis for making the suo-motu disallowance stating that vis-a-vis investments made directly the assessee had disallowed Rs. 50,000/- while in relation to those investments made through PMS, the assessee had worked out the proportionate amount of expenses incurred on PMS in the ratio of taxable income to non-taxable income generated by the PMS and disallowed the same. It was pointed out from para 13 of the order that after noting the said fact, the ITAT found that the AO in his entire order had not given any finding as to why this basis of calculating the disallowance of expenses was incorrect, but had only stated that as per the provisions of Section 14A the onus was on the assessee to prove that it had not incurred any expenditure to own exempt income, which the assessee had not been able to discharge. It was pointed out that the ITAT found this to be factually incorrect, noting that it was never the claim of the assessee that it had not incurred any expenditure, having suo-motu made disallowance of expenditure. The ITAT therefore, held that there was no satisfaction of the AO regarding the incorrectness of the claim of the assessee of expenditure incurred in relation to expenditure incurred for earning exempt income and accordingly, the disallowance computed by the AO was deleted.

(8) Our attention drawn to para 13 of the order which is reproduced hereunder:

13. In the facts of the present case, we find that the assessee had suo-motu made a disallowance of expenses incurred in relation to earning of exempt income amounting to Rs. 1,84,871/-. During assessment proceedings, the assessee had explained the basis for making the impugned disallowance submitting a calculation of the same also. The assessee had explained that it had made certain investments directly while others had been made through Portfolio Management Services. In relation to those investments which had been made directly, it had disallowed expenses of Rs. 50,000/- while in relation to those investments made through PMS, it had worked out the proportionate amount of expenses incurred on PMS in the ratio of taxable income to non-taxable income generated by the PMS and disallowed the same. Therefore, the assessee had explained the rationale of making the suo-motu disallowance to the AO. As rightly pointed out by the Id. counsel for the assessee the AO in his entire order has not given any finding as to why this basis of calculating the disallowance of expenses was incorrect. The AO has only stated that as per the provisions of Section 14A, the onus was on the assessee to prove that it had not incurred any expenditure to earn the exempt income and assessee has not been able to discharge its onus. This finding of the AO is, we find, factually incorrect because it is not the claim of the assessee that it has not incurred any expenditure. The assessee had himself suo-motu made disallowance of this expenditure. Therefore, this finding of the AO is totally irrelevant. Further, the AO has stated that in the absence of any direct evidence of expenses incurred to earn exempt income, disallowance u/s 14A is to be computed as per Rule 8D and has further stated that since the assessee had mixed funds, Rule 8D was applicable. This finding of the AO also, we find, does not

dislodge the explanation of the assessee regarding the disallowance computed by it. Therefore, clearly there is no satisfaction of the AO regarding the incorrectness of the claim of expenditure by the assessee incurred in relation to earning exempt income. In view of the same, the disallowance computed by the AO is bad in law and is, therefore, directed to be deleted.

(9) Ld. Counsel for the assessee contended that the facts in the present case were to that in the assessment year 2013-14. Taking us through the assessment order, for the impugned year, Ld. Counsel for the assessee pointed out from para 4.1 thereof that it had explained the basis of making the suo-motu disallowance u/s 14A of Rs. 2,66,084/-, as Rs. 1,00,000/- against investments made directly and remaining on account of proportionate amount paid through PMS which was calculated by applying the total amount paid to the PMS in the ratio of taxable income and non-taxable income generated by the PMS. The calculation of the same was also attached. The reply of the assessee in para 4.1 of the AO's order is reproduced hereunder:

The assessee vide reply dated 21.03.2016 stated that:-

That the assessee during the year under consideration earned dividend {income of Rs.22.57 lacs against the investments made.

The assessee company disallowed Rs.2,66,084/- in compliance with the provision of Section 14A. The calculation of said amount is attached at annexure-5. A perusal of the the same reflects that the assessee disallowed Rs. 1,00,000/- against the investments made by it directly and the remaining Rs. 1,66,084/- on account of proportionate amount paid to PMS. The said proportionate amount was calculated by applying to the total amount paid to PMS the ratio of taxable income and non taxable income generated by PMS. The assessee therefore adopted a rational method to disallow expenditure in relation to exempt income.

(10) Ld. Counsel for the assessee thereafter contended that the AO after considering the reply of the assessee has nowhere discussed in the assessment order as to how the above claim of the assessee was not correct. Drawing our attention to para 4.2 of the order, Ld. Counsel for the assessee pointed out that the said paragraph probably recorded the satisfaction of the AO since the same was mentioned in bold as under:

*4.2 The reply of the assessee has been considered and is found to be unacceptable. A perusal of the Balance Sheet as on 31.3.2014 shows that the assessee has invested an amount of Rs.31,75,27,000/- as on 31.03.2014 and Rs.224,34,61,000/- as on 31.03.2013 in various equity funds and shares of different companies including group companies earning tax free income in the form of dividends etc. The assessee has taken huge loans and on the other hand is investing indirectly from loan funds and the common kitty of funds, so as to avoid the tax liability. No separate books of accounts or funds are being maintained by the assessee for making investment and to account for the exempt income, being earned by the assessee. **Hence, I am satisfied that disallowance u/s 14A needs to be made in this case.***

(11) Referring to the same, Ld. Counsel for the assessee pointed out that it is clear from the above that there was no satisfaction recorded in the same by the AO vis-a-vis the incorrectness of the claim of the assessee as explained to the AO since there is no reference to the same at all. Ld. Counsel for the assessee

contended that in view of the same the issue was squarely covered by the decision of the ITAT in assessment year 2013-14 in the case of the assessee.

(12) Ld. DR, on the other hand, heavily relied upon the findings of the Ld. CIT(A), that the assessee had suo-motu made disallowance and was thus ad idem with the applicability of the Section 14A and therefore, the requisite conditions, for invoking the provisions of Section 14A, were rightly found to be applicable in the facts and circumstances of the case. It was also pointed out that the Ld.CIT(A) had found that the assessee had maintained common and un-demarcated funds and could not identify the utilization of non-interest bearing funds for making investments and therefore, in these circumstances the allegation against the AO in not recording his satisfaction was incorrect. Our attention was drawn to the findings of the Ld. CIT(A) at para 6 of his order as under:

6. The submissions of the appellant and the basis of the impugned disallowance made by the AO have been carefully considered. The appellant has, admittedly, earned exempt income during the year under consideration, for which a voluntary disallowance of Rs.2,66,084/- was made in the return of income. This clearly indicates that the appellant is ad idem with the applicability of section 14A in the facts and circumstances of the case. It is, therefore, held that the requisite conditions for invoking the provisions of section 14A are found to be applicable in the facts and circumstances obtaining in the case of the appellant in as much as there has been a receipt of exempt income. The outlay in terms of interest on borrowed capital is also a fact on record. That the appellant company maintains common and un-demarcated funds is also not disputed. It is also fairly understandable that the appellant could not identify or demarcate the utilization of non-interest-bearing funds for making investments because of the common pool of funds as also on account of the enormity of the same. Similarly, in view of the massive turnover of the appellant company and its complicated fund flow, the difficulty in identifying as to which funds have been used for what purposes also cannot be emphasised more. There is no doubt about the unity of control and commonality of funds and management in relation to the "business activity" and "investment activity, income from which does not or shall not form part of the total income". In the circumstances, the allegation against the AO in not recording his satisfaction before rejecting the appellant's calculation rings hollow and an artifice to turn the tables and expect from the AO, what should have been known and pointed out by the appellant itself. It is seen that the AO has dealt with the matter while rejecting the appellant's calculations and invoking the machinery provision of Rule 8D and his satisfaction can be easily and clearly discerned from the assessment order.

(13) We have heard the contentions of both the parties, perused the orders of the authorities below and have also gone through the decisions referred to by the Ld. Counsel for the assessee before us.

(14) After considering the same, we are in agreement with the contention of the Ld. Counsel for the assessee that the facts in the present case are identical to that in the case of the assessee for assessment year 2013-14 ,which was decided by the ITAT in ITA No. 1510/Chd/2017 dated 20.12.2018. It has been duly demonstrated before us that as in that case, in the impugned year also the assessee had explained the basis of working out the suo-motu disallowance made of expenses u/s 14A and had also provided a calculation of the same to

the AO pointing out that a sum of Rs. 1,00,000/- had been disallowed on account of investments directly made by the assessee, while for the investments made through PMS the total expenses incurred on the PMS were apportioned in the ratio of taxable income and non-taxable income earned from the investments and the amount relating to the non-taxable income was accordingly disallowed by the assessee. That as in the case of the assessee in assessment year 2013-14, in the impugned year also ,we find , the AO has not recorded any finding as to why he found the calculation of the disallowance of expenses u/s 14A made by the assessee as above to be incorrect. The AO, as in the case of assessment year 2013-14 has only made general statements regarding the availability of mixed funds . Even the Ld. DR was unable to point out before us any findings of the AO regard the incorrectness of the claim of expenses disallowable made by the assessee. The Ld. DR has been unable to point out any distinguishing facts before us.

The issue therefore, we agree with the Ld. Counsel for the assessee, is squarely covered by the decision of the ITAT in the case of the assessee for assessment year 2013-14. Following the same ,we therefore hold that in the absence of any satisfaction recorded by the AO vis-a-vis incorrectness of the claim of the assessee of expenses disallowable u/s 14A of the Act, the disallowance made by the AO is bad in law. The same is therefore, directed to be deleted.

(15) Since we have deleted the disallowance made u/s 14A for the aforesaid reasons, we do not consider it necessary to deal with the other contentions raised by the Ld. Counsel for the assessee vis-a-vis the availability of sufficient own funds warranting no disallowance u/s 14A and against the applicability of the amended provisions of Rule 8D of the Rules.

(16) In the result, the appeal of the assessee is allowed.

(17) We shall now be taking up the appeal of the Revenue.

Ground no. 1 reads as under:

“1. Whether upon facts and circumstances of the case, the Ld. CIT(A) was justified in allowing relief on account of the disallowance u/s 14A of the Income Tax Act, 1961 read with Rule 8D of Income Tax Rules, 1962 by applying amended provisions of Rule 8D (14th Amdt), while the same amendment was introduced w.e.f. 02.06.2016 and does not have retrospective effect?”

(17.1) The above ground relates to the issue of disallowance of expenses u/s 14A of the Act challenging the direction of the Ld. CIT(A) to apply the amended

provisions of Rule 8D of the Rules. Since, we have deleted the disallowance made while adjudicating the assessee's ground raised in this regard in its appeal above, the ground raised above by the Revenue becomes infructuous and is therefore, dismissed.

(18) Ground no. 2 raised by the Revenue reads as under:

"2. Whether upon facts and circumstances of the case, the Ld. CIT(A) was justified in deleting the addition made on account of disallowance u/s 36(1)(iii) of the Income Tax Act, 1961?"

(18.1) The above ground relates to disallowance of interest expenses made u/s 36(1)(iii) of the Act. The brief facts relating to the issue are that the AO noted that the assessee company had made investments in shares / mutual funds which were financed by common pool of funds comprising of both interest bearing and non-interest bearing funds. Since, the funds utilized for the purpose of making the investments could not be identified and the assessee was not engaged in the business of making investments, the AO show caused the assessee to explain why the claim of expenditure on interest may not be disallowed pertaining to that incurred for making investments which were not for the purpose of business of the assessee. The assessee contended that it had sufficient interest free funds for making the investments warranting no disallowance u/s 36(1)(iii) of the Act. The AO dismissed the contentions of the assessee and disallowed interest, working out the same at the rate of 12% on the investments in shares / mutual funds which were not considered to be for non business purpose. The disallowance was accordingly worked out at Rs. 373.29 lakhs which was restricted to 358.99 lakhs after taking into account interest already disallowed under the provisions of Section 14A of the Act.

(19) The Ld. CIT(A) deleted the disallowance on finding that the assessee had sufficient own interest free funds for the purpose of making the impugned investments.

(20) Before us, Ld. DR relied on the order of the AO, while the Ld. Counsel for the assessee relied on the order of the CIT(A) and further, pointed out that identical issue had arisen in the case of the assessee in assessment year 2012-13 and 2013-14 in ITA No. 574/Chd/2017 dated 11.12.2017 and ITA No. 1518/Chd/2017 dated 20.12.2018 respectively, wherein the issue was decided in favour of the assessee on finding that sufficient own interest free funds were available with the assessee and relying upon the decision of the jurisdictional

High Court in the case of M/s Bright Enterprises Pvt. Ltd vs. CIT (2015) 234 Taxman 509.

(21) We have heard the contentions of both the parties and perused the orders of the authorities below and also gone through the decisions referred to before us. The finding of the fact recorded by the Ld. CIT(A) that the assessee has sufficient own interest free funds for making the investments has not been controverted by the Revenue before us. In fact, we find, that the Ld.CIT(A) has noted that the AO did not contest this plea of the assessee in the assessment order. Further it is an admitted fact that in identical facts and circumstances disallowance made u/s 36(1)(iii) in earlier years had been deleted by the ITAT. The Ld. DR has been unable to point out any distinguishing facts before us. Moreover, we find that the Hon'ble Apex Court in recent decision in the case of Commissioner of Income Tax(Large Taxpayers Unit) vs *Reliance Industries* in Civil Appeal No.10 of 2018 & others dated 02-01-2019, has settled the proposition of law that where sufficient own interest free funds are available the presumption is that the same were used for the purpose of making non-business purpose advances calling for no disallowance of interest u/s 36(1)(iii) of the Act. The relevant findings in this regard are as under:

Insofar as the first question is concerned, the issue raises a pure question of fact. The High Court has noted the finding of the Tribunal that the interest free funds available to the assessee were sufficient to meet its investment. Hence, it could be presumed that the investments were made from the interest free funds available with the assessee. The Tribunal has also followed its own order for Assessment Year 2002-03. In view of the above findings, we find no reason to interfere with the judgment of the High Court in regard to the first question. Accordingly, the appeals are dismissed in regard to the first question

22. In view of the same, the order of the Ld. CIT(A) deleting the disallowance of interest u/s 36(1)(iii) in the present case is upheld. Ground no. 2 of the appeal raised by the Revenue is therefore, dismissed.

(23) In the result, the appeal of the Revenue is dismissed.

Order pronounced in the Open Court on 04.04.2019.

(SANJAY GARG)
JUDICIAL MEMBER
Dated : 04/04/2019
BCG

(ANNAPURNA GUPTA)
ACCOUNTANT MEMBER

Copy to: 1.The Appellant, 2. The Respondent, 3. The CIT(A), 4. The CIT, 5. The DR