

noticed that the assessee company has earned dividend income and also income from units of mutual funds aggregating to Rs.23,79,908/- which is exempt from tax. The assessee was therefore, required to show-cause as to why the provisions of section 14A r.w.r 8D should not be invoked. The assessee submitted that there is no disallowance by him u/s 14A since the investment in mutual funds was not made out of borrowed funds and no direct expenditure can be attributable to earning of dividend (exempt) income. It was also submitted that no interest payment is made on account of borrowed funds. The AO however, observed that Rule 8D(2)(iii) is applicable and accordingly made the disallowance u/s 14A of the Act.

3. Aggrieved, the assessee preferred an appeal before the CIT (A) who upheld the order of the AO and the assessee is in second appeal before us by raising the following grounds of appeal:

“1. The learned commissioner of Income Tax (Appeals) - 3, Hyderabad [CIT(A)] has erred on facts and in law, in dismissing the appeal of the assessee.

2. Learned CIT(A) has erred in observing that the Assessing Officer (A.O.) was reasonable enough to disallow an amount of Rs.3,64,431/- out of expenses of Rs.7,71,934 -(22,71,934 - 15,00,000/-), whereas he mechanically applied Rule 8D(2)(iii) LW.S. 14A of the I.T. Act without reaching satisfaction.

3. Learned CIT(A) has also erred in holding that substantial funds were invested and expenses claimed has proximate nexus with earning of Dividend income. This is against the facts of the case because no expenditure was incurred to receive or earn Dividend income, all the funds invested being own funds. Dividends get directly credited in the Bank A/c of the assessee and no expenditure is incurred for the purpose.

4. Learned CIT(A) has erred in coming to the conclusion that observation of the A.O that substantial funds were invested and expenses claimed has proximate nexus with earning of Dividend indicates satisfaction on the part of the A.O, under Sec. 14A of the LT. Act r.w.s Rule 8D whereas A.O has not indicated only such satisfaction.

5. Assuming that the observations of the A.O. amount to his satisfaction u/s 14A r.w.s Rule 8D, learned CIT (A) has erred in holding that substantial investments of own funds has any nexus with any of the items of expenses claimed. The two are totally unconnected.

6. For these and any other Grounds that may be raised at/before the time of hearing, it is prayed that the disallowance made by the A.O, and upheld by the Learned CIT(A) be kindly deleted”.

4. Further, the assessee also raised the following additional ground of appeal:

“Without prejudice to the grounds of appeal already filed, the disallowance under Rule 8D(2)(iii) should be on the basis of average of the investments which have yielded exempt income that is dividend income in the previous year and not on the entire investments adopted by the AO”.

5. Upon hearing both the parties, we find that for the A.Y 2012-13, the provisions of section 14A r.w.r 8D(2)(iii) of the Act are applicable. The AO has made disallowance u/s 8D(2)(iii) of the I.T. Act i.e. 0.5% of the average investments. In a number of cases, this Tribunal has held that the disallowance under Rule 8D(2)(iii) is to be calculated on the average value of the investments which have yielded exempt income only. In the case of Yashoda Health Care Services (P) Ltd vs. Dy. CIT reported in (2017) 54 ITR (Trib.) 26 (ITAT Hyderabad) (to which both of us i.e. AM & JM are signatories) the Tribunal at Para 6 of its order held as under:

“6. Considered the rival submissions and perused the material facts on record. We find that a similar issue came up for consideration before the

co-ordinate Bench of this Tribunal in the case of Transport Corporation of India Ltd. v. Asstt. CIT [IT Appeal No. 117 (Hyd.) of 2016, dated 21-9-2016] wherein the co-ordinate Bench has held as under :

"11.1 While carefully reading the rule 8D(2)(ii), the formula given are :

<i>A</i>	<i>x</i>	<i>B</i>
		<i>C</i>

Where A = amount of expenditure by way of interest other than the amount of interest included in clause (i) incurred during the previous year :

B = the average of value of investment, income from which does not or shall not form part of the total income, as appearing in the balance-sheet of the assessee, on the first day and the last day of the previous year ;

C = the average of total assets as appearing in the balance sheet of the assessee, on the first day and the last day of the previous year ;

In particular, the notes for 'B' clearly states that the average value of investment, income from which does not or shall not form part of the total income. It is clear that we have to include those investments which has generated income and exclude those investments, which have not generated income. In the present case, the Assessing Officer had taken the total investment instead of those investments, which have generated income. Accordingly, we direct the Assessing Officer to calculate the disallowance of interest as below (as per rule 8D) :

<i>Interest</i>	<i>x</i>	<i>Investment (which generated income)</i>
		<i>Average total assets</i>

The main reason is that as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which is exempt from tax. The relevance is the expenditure in relation to income. The quantification has to be undertaken in relation to the exempt income. The investment which has not generated exempt income should be excluded from the calculation of ratio to determine the disallowance.

11.2 Similarly, for the administrative expenses, 0.5 per cent. of average investments from which the exempt income is received should be considered instead of average of the total investments.

11.3 Considering the above discussion, we direct the Assessing Officer to recalculate the disallowance as per rule 8D as per the above guidance. Accordingly, ground raised by the assessee is allowed."

As the issue under consideration is materially identical to that of the said case, following the conclusions drawn therein we direct the Assessing Officer to recalculate the disallowance as per rule 8D as per the guidelines given as above in the case of Transport Corporation of India and calculate the disallowance of

expenditure under rule 8D(2)(iii) taking the average investment from which the exempt income is received”.

6. Respectfully following the same, we direct the AO to recalculate the disallowance u/s 14A r.w.r 8D(2)(iii) only in accordance with the above directions. The assessee’s appeal is accordingly allowed for statistical purposes.

7. In the result, assessee’s appeal is allowed for statistical purposes.

Order pronounced in the Open Court on 31st July, 2019.

Sd/-
(S.Rifaur Rahman)
Accountant Member

Sd/-
(P. Madhavi Devi)
Judicial Member

Hyderabad, dated 31st July, 2019.

Vinodan/sps

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- 3 CIT (A)-3 Hyderabad
- 4 Pr. CIT – 3 Hyderabad
- 5 The DR, ITAT Hyderabad
- 6 Guard File

By Order