

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "D" MUMBAI**

**BEFORE SHRI C.N. PRASAD (JUDICIAL MEMBER) AND
SHRI N.K. PRADHAN (ACCOUNTANT MEMBER)**

**ITA No. 326/MUM/2018
Assessment Year: 2009-10**

&

**ITA No. 327/MUM/2018
Assessment Year: 2011-12**

&

**ITA No. 328/MUM/2018
Assessment Year: 2012-13**

ITO-13(3)(3), Room No.
227, 2nd floor,
AayakarBhavan, M.K. Road,
Mumbai-400020.

Manoj VashudevWadhwa,
Vs. 11, Happy Home, 244,
Waterfield Road, Bandra
West, Mumbai-400050.

PAN No. AALPW0303K

Appellant

Respondent

**ITA No. 359/MUM/2018
Assessment Year: 2009-10**

&

**ITA No. 360/MUM/2018
Assessment Year: 2011-12**

&

**ITA No. 361/MUM/2018
Assessment Year: 2012-13**

Manoj VashudevWadhwa,
11, Happy Home, 244,
Waterfield Road, Bandra
West, Mumbai-400050.

ACIT CC 37
Vs. AayakarBahvan, Mumbai.

PAN No. AALPW0303K

Appellant

Respondent

Revenue by : Ms.JothilakshmiNayak, DR
Assessee by : Mr. Nitesh Joshi, AR

Date of Hearing : 27/09/2019
Date of pronouncement: 16/10/2019

ORDER

PER BENCH

The captioned cross appeals filed by the revenue and assessee are directed against the order of the Commissioner of Income Tax (Appeals)-33, Mumbai (in short 'CIT(A)') are arise out of the assessment order passed u/s 143(3) of the Income Tax Act 1961, (the 'Act').In this batch of appeals, the controversy raised being similar, they were heard analogously and are disposed of by a common order. We begin with the assessment year (AY) 2009-10.

ITA No. 326/MUM/2018 **Assessment Year: 2009-10**

2. The grounds of appeal filed by the revenue read as under:
 1. On the facts and circumstances of the case and in law, the CIT(A) has erred in restricting the disallowance u/s 14A r.w. Rule 8D(2)(ii) to the extent of exempt income amounting to Rs.23,88,051/- as against Rs.44,61,102/- disallowed by the AO for A.Y. 2009-10.
 2. On the facts and circumstances of the case and in law, the decision of the CIT(A) in restricting the disallowance u/s 14A r.w. Rule 8D(2)(ii) to the extent of exempt income is not acceptable as Department's SLP on the issue of Section 14A is pending before the Hon'ble Supreme Court in the case of Essar Teleholdings Ltd. (CA No. 2165/2012).

3. The appellant prays that the order of the CIT (A) on the above grounds be set aside and that of the Assessing Officer be restored.

ITA No. 359/MUM/2018
Assessment Year: 2009-10

3. The grounds of appeal filed by the assessee read as under :
 1. The CIT(A) erred in upholding the disallowance under section 14A of the Act of Rs.23,88,051 determined by applying the provisions of rule 8D of the Income-tax Rules, 1962 (the Rules).
 2. The CIT(A) ought to have held that the pre-conditions to be satisfied before application of rule 8D had not been fulfilled in the present case.
 3. The CIT(A) ought to have held that no disallowance could be made under section 14A of the Act in respect of expenditure allegedly incurred towards earning of exempt income from investments held as stock in trade.
 4. The CIT(A) ought to have held that no disallowance could be made under section 14A of the Act in respect of expenditure allegedly incurred towards earning of income from investment that are strategic in nature.
 5. The CIT(A) ought to have held that no disallowance could be made under section 14A of the Act in respect of those investments which did not yield any exempt income during the year.
4. In a nutshell, the facts are that the assessee filed his return of income for the A.Y. 2009-10 on 30.09.2009 declaring total income of Rs.49,10,950/-, claiming current year loss of Rs.29,19,34,970/-. Thereafter, he filed a revised return of income on 04.03.2010 declaring total income at Rs. Nil, claiming current year loss of Rs.29,31,93,246/-.

In the computation of income, the assessee has shown dividend income of Rs.23,88,051/- and claimed it as exempt u/s 10(34) of the Act.

Similarly, it claimed share of profit from firms at Rs.61,590/-. During the course of assessment proceedings, the Assessing Officer (AO) asked the assessee to explain as to why provisions of section 14A r.w. Rule 8D should not be applied. In response to it the assessee filed a reply which has been produced at para 4.2 of the assessment order. In the said reply, the assessee has explained that out of the total expenses of Rs.5,50,716/- a reasonable amount calculated @ 2% which works out to Rs.11,014/- be disallowed. However, the AO was not convinced with the above reply of the assessee for the reason that :

“It is seen from the details filed by the assessee that it has shown to have earned dividend income at Rs.23,88,051/- and share of profit from firms at Rs.61,590/- which does not form part of total income. However, the assessee has not attributed any expenses which have been incurred to earn this income. In the computation of income filed along with return of income, the assessee has not made disallowance of any expenditure incurred for earning the income which does not form part of total income. In the P&L account, the assessee has debited various expenses such as salary, bonus, audit fees, sundry expenses, office expenses professional expenses, other expenses, etc.”

With the above reasons and following the order of the Hon'ble Bombay High Court in *Godrej & Boyce Manufacturing Co. Ltd. v. DCIT* (2010) 194 Taxman 203 (Bom), the AO computed the disallowance u/s 14A r.w. Rule 8D at Rs.44,61,102/-.

5. In appeal, the Ld. CIT(A) directed the AO to restrict the disallowance to the extent of exempt income i.e. dividend of Rs.23,88,051/-. The Ld. CIT(A) followed the submission before him by the

assessee that without prejudice to the other grounds of appeal, the disallowance u/s 14A r.w. Rule 8D cannot exceed the exempt income as per the decision of the Hon'ble Delhi High Court in *Joint Venture Pvt. Ltd. v. CIT* (ITA No. 117/2015).

6. Before us, the Ld. DR submits that the disallowance computed by the AO at Rs.44,61,102/- be confirmed as it is based on calculation as per section 14A r.w. Rule 8D.

7. The Ld. counsel submits that before invoking the provisions of Rule 8D, for computing the amount of disallowance u/s 14A of the Act, the AO has to record his dissatisfaction with *the suo motu* disallowance made by the AO in an objective manner. In this regard, reliance is placed by him on the decision in *Godrej & Boyce Mfg. Co. Ltd. v. DCIT* 328 ITR 81 (Bom) [paras 70 and 71 at pages 120 and 121 of the Report] and *Godrej & Boyce Mfg. Co. Ltd. v. DCIT* 394 ITR 449 (SC) [para 37 at page 471 of the Report]. It is stated by him that in the present case the assessee has followed the formula laid down in Rule 8D and applied the same to the average value of investment. Thus it is stated that in these circumstances, the dissatisfaction, if any, as recorded by the AO has no objective basis and if this proposition is accepted, then the disallowance as made by the assessee needs to be accepted.

Alternatively, the Ld. counsel submits that investments which have not yielded dividend income may be excluded from the investments for computation of average value of investments for the purposes of Rule 8D.

In this regard, reliance is placed by him on the decision in *ACIT v. Vireet Investment (P.) Ltd.* 165 ITD 27 (Del) (SB).

Another limb of the alternate submission made by the Ld. counsel is that stock-in-trade may be excluded from the investments for computation of average value of investments for the purpose of Rule 8D. In this regard, reliance is placed by him on the order of the Tribunal in the case of *Nice Bombay Transport (P.) Ltd. v. ACIT*, order dated 19.11.2018 in ITA No. 1331/Del/2012 and *Punjab National Bank v. ACIT* order dated 28.11.2018 in ITA No. 1519/Del/2016.

8. In AY 2011-12, the assessee received dividend income of Rs.14,46,570/- exempt u/s 10(34) and share of profit from firm of Rs.13,45,39,258/-. In the assessment order dated 25.03.2014, the AO has recorded that as per the balance sheet of the assessee, the borrowings have increased and so his investment and stock in shares. As per the balance sheet, the assessee has made investment in mutual funds, shares etc. In the profit and loss account the assessee has claimed several expenses including interest expenses ; however no expenditure has been disallowed in relation to earning of exempt income in the computation of income. Observing the above, the AO asked the assessee to explain why disallowance u/s 14A r.w. Rule 8D should not be made. In reply to it, the assessee filed a submission which was not acceptable to the AO. Therefore, he computed the disallowance u/s 14A r.w. Rule 8D at Rs.1,37,88,145/-. In the statement of income the assessee has *suo motu* disallowed Rs.1,27,488/- on account of expenses debited to the P&L

account which relate to exempt income. The AO disallowed the balance amount of Rs.1,36,60,657/- (Rs.1,37,88,145/- *minus* Rs.1,27,488/-) u/s 14A of the Act.

9. In appeal, the Ld. CIT(A) directed the AO to restrict the disallowance to the extent of exempt income .

10. Before us, the Ld. DR submits that the disallowance computed by the AO at Rs.1,36,60,657/- be confirmed as it is based on calculation as per section 14A r.w. Rule 8D.

11. Besides the similar submission made for AY 2009-10, the Ld. counsel submits that the assessee carried out business of share trading and derivative trading and dividend income earned is incidental to the business of the assessee and that the borrowing made were not for the purpose of earning dividend. It is further stated that the expenditure incurred in earning dividend income and share of profit can only be disallowed and there are no direct expenses incurred for earning dividend income and share in profit, hence, no such disallowance is called for. It is further stated that in the assessee's case there is no new investment in shares during the year under appeal and in fact there is no new investment in shares since 2005-06 onwards. Also it is pointed out for disallowance u/s 14A r.w. Rule 8D, the AO while calculating the average investments has included to the credit balance of firms in the books of the assessee, whereas for the purpose of 14A r.w. Rule 8D only average investment is to be taken and not the credit balance with firms as

it is not a investment in the books of firms but it is a liability payable to the firm.

12. For AY 2012-13, the assessee has filed the following additional grounds of appeal:

1. The AO while working out disallowance u/s 14A r.w. Rule 8D of the Act has made calculation error while working out average investments in shares and stock in trade in shares. The average investment is wrongly worked out at Rs.25,06,40,395/- instead of Rs.12,53,20,197/-.
2. While working out disallowance under 14A r.w. Rule 8D, the AO has calculated disallowance of Administrative Expenses wrongly at Rs.12,53,20,198/- i.e. 50% of Rs.25,06,40,395/- instead of 0.5% of Rs.12,53,20,197/- which works out to Rs.6,26,601/-.
3. The Ld. CIT(A) has failed to dispose of grounds (No. 10 & 17) with regard to calculation error of average investments and disallowance of Administrative Expenses @ 0.5% of Rs.12,53,20,0197/-.

13. As the additional ground filed by the assessee relate to the original grounds of appeal and supported by documents filed before the AO, we admit it for adjudication.

14. During the course of assessment proceedings, the AO examined the balance sheet of the assessee and observed that the assessee has made investment in mutual funds, shares etc.; the income earned from those investment would be exempt; however, no expenditure has been disallowed in relation to earning on exempt income in the computation of income. Therefore, the AO asked the assessee to explain why the disallowance u/s 14A r.w. Rule 8D should not be made. He also asked the

assessee to furnish the working of disallowance u/s 14A of the Act. The assessee *vide* his reply dated 02.02.2015 filed a working of disallowance of Rs.1,27,488/- before the AO. However, the AO was not convinced with the above explanation of the assessee for the reason that the basic object of introduction of section 14A into the Act is to disallow the direct and indirect expenditure in relation to income which does not form part of total income irrespective of the fact that business is composite or not. Further observing that the assessee has invested in shares and mutual funds whose income would be exempt and during the year under consideration the assessee has received dividend income and that the expenditure has been incurred for the day to day activities and there would be no doubt that a part of the same is relatable to the earning of exempt income. Therefore, the AO made a disallowance of Rs.15,09,62,609/- u/s 14A r.w. Rule 8D. As the assessee in the statement of income has *suo motu* made a disallowance of Rs.1,27,488/-, the AO restricted the disallowance to Rs.15,08,35,121/- (Rs.15,09,62,609/- minus Rs.1,27,488/-).

15. In appeal, the Ld. CIT(A) directed the AO to restrict the disallowance to the extent of exempt income i.e. upto dividend of Rs.12,54,587/- and profit from firm of Rs.9,60,11,832/-.

16. Before us, the Ld. DR submits that the disallowance of Rs.15,08,35,121/- made by the AO u/s 14A r.w. Rule 8D be affirmed as the same has been done as per the provisions of the Act.

17. On the other hand, the Ld. counsel, in addition to the contentions for AYs 2009-10 and 2011-12 submits that the AO has committed the following mistakes in computation of disallowance u/s 14A r.w. Rule 8D:

- i. The value of investments and stock in trade as on 01.04.2011 was Rs.10,73,16,376 and as on 31.03.2012 was Rs.14,33,24,019. The aggregate value of such investments as at the beginning and at the end of the year was Rs.25,06,40,395 (being Rs. 10,73,16,376 + Rs. 14,33,24,019). The average value of investments would be Rs. 12,53,20,197 (being ½ of Rs.25,06,40,395). However, the AO has erroneously treated the amount of Rs.25,06,40,395 being the aggregate value of such investments as at the beginning and at the end of the year as the average value of investment instead of Rs. 12,53,20,197. This will have an impact on the computation of disallowance as per rule 8D(2)(ii) and (iii).
- ii. For the purpose of rule 8D(2)(iii) 0.5% has to be applied to the average value of investments. Firstly, as stated above, the average value of investments have been taken as Rs. 25,06,40,395 (instead of Rs. 12,53,20,197). Secondly, though in para 5.3(a) at page 3 of the assessment order the AO has stated 0.5% of the average value of investment, he has actually applied 50% to Rs. 25,06,40,395 and worked out the amount of disallowance under rule 8D(2)(iii) at Rs. 12,53,20,197 instead of Rs. 6,26,600 (being 0.5% of Rs.12,53,20,197).
- iii. The final calculation under Rule 8D shall be as under:

Interest as per rule 8D(2)(ii)	
$7,65,44,326 * 12,53,20,197 / 71,83,27,810$	1,33,54,000
Administrative expenses as per rule 8D(2)(iii) 0.5% of Rs. 12,53,20,197	6,26,600
Total	1,39,80,600

Regarding the cross appeal filed by the Revenue challenging the order of the CIT(A) that the disallowance u/s 14A of the Act cannot exceed the exempt income, the Ld. counsel submits that this issue stands covered in favour of the assessee by the judgment of the Hon'ble Bombay High Court in *Nirved Traders Pvt. Ltd. v. DCIT* order dated 23.04.2019 in ITA No. 149 of 2017. A copy of the order was filed by him.

18. We have heard the rival submissions and perused the relevant materials on record. The reasons for our decisions are given below.

Let us first examine the contentions of the Ld. counsel that before invoking the provisions of Rule 8D, for computing the amount of disallowance u/s 14A of the Act, the AO has to record his dissatisfaction with *the suo motu* disallowance made by the AO in an objective manner. In this regard, reliance is placed by him on the decision in *Godrej & Boyce Mfg. Co. Ltd.* (Bom) [paras 70 and 71 at pages 120 and 121 of the Report] and *Godrej & Boyce Mfg. Co. Ltd.* (SC) [para 37 at page 471 of the Report].

As mentioned earlier, in AY 2009-10 *vide* order sheet entry dated 21.11.2011, the AO asked the assessee to explain as to why the provisions of section 14A r.w. Rule 8D should not be applied to his case. The assessee filed a reply which has been extracted by the AO at para 4.2 of the assessment order dated 22.11.2011. In that reply, the assessee explained that out of total expenses of Rs.5,50,716/-, a reasonable amount calculated @ 2% may be disallowed which works out to Rs.11,014/-. However, the AO was not convinced with the said explanation of the

assessee for the reason that in the computation of income the assessee has not made disallowance of any expenditure incurred for earning income which does not form part of total income. Thereafter, following the judgment of the Hon'ble Bombay High Court in *Godrej & Boyce Manufacturing Co. Ltd.* (supra), he computed the disallowance u/s 14A r.w. Rule 8D.

For AY 2011-12, during the course of assessment proceedings, the AO asked the assessee to explain as to why the disallowance u/s 14A r.w. Rule 8D should not be made. In response to it the assessee filed a reply which was not acceptable to the AO for the reason that the basic object of introduction of section 14A in the Act is to disallow the direct and indirect expenditure incurred in relation to income which does not form part of total income irrespective of the fact that business is composite or not. Thereafter, the AO computed the disallowance u/s 14A r.w. Rule 8D. We refer here to para 4.1 and 4.2 of the assessment order dated 25.03.2014 passed by the AO.

For AY 2012-13, during the course of assessment proceedings, the AO asked the assessee to explain as to why the disallowance u/s 14A r.w. Rule 8D should not be made. The AO also asked the assessee to furnish working of disallowance u/s 14A of the Act. The assessee *vide* reply dated 02.02.2015 filed working of disallowance at Rs.1,27,488/-. However, the AO was not convinced with above reply of the assessee for the reason that the basic object of introduction of section 14A in the Act is to disallow the direct and indirect expenditure incurred in relation to income which does

not form part of total income irrespective of the fact that business is composite or not. Thereafter, the AO computed the disallowance u/s 14A r.w. Rule 8D. We refer here to para 5.1 and 5.2 of the assessment order dated 13.03.2015 passed by the AO.

Thus it is quite clear that in the present case the AO was not satisfied with the claim of the assessee. The AO, having regard to the accounts of the assessee has arrived at a finding that it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the assessee. Only thereafter, the AO has made the disallowance u/s 14A r.w. Rule 8D. Therefore, we are not inclined to agree with the contentions of the Ld. counsel that no satisfaction has been recorded by the AO in an objective manner.

18.1 In the case of *Maxopp Investment Ltd. v. CIT* (2018) 91taxmann.com 154(SC), the Hon'ble Supreme Court has held at para 36-39 the following :

“36. There is yet another aspect which still needs to be looked into. What happens when the shares are held as 'stock-in-trade' and not as 'investment', particularly, by the banks? On this specific aspect, CBDT has issued circular No. 18/2015 dated November 02, 2015.

37. This Circular has already been reproduced in Para 19 above. This Circular takes note of the judgment of this Court in Nawanshahar case wherein it is held that investments made by a banking concern are part of the business or banking. Therefore, the income arises from such investments is attributable to business of banking falling under the head 'profits and gains of business and profession'. On that basis, the Circular contains the decision of the Board that no appeal would be filed on this ground by the officers of the Department and if

the appeals are already filed, they should be withdrawn. A reading of this circular would make it clear that the issue was as to whether income by way of interest on securities shall be chargeable to income tax under the head 'income from other sources' or it is to fall under the head 'profits and gains of business and profession'. The Board, going by the decision of this Court in Nawanshahar case, clarified that it has to be treated as income falling under the head 'profits and gains of business and profession'. The Board also went to the extent of saying that this would not be limited only to co-operative societies/Banks claiming deduction under Section 80P(2)(a)(i) of the Act but would also be applicable to all banks/commercial banks, to which Banking Regulation Act, 1949 applies.

38. From this, Punjab and Haryana High Court pointed out that this circular carves out a distinction between 'stock-in-trade' and 'investment' and provides that if the motive behind purchase and sale of shares is to earn profit, then the same would be treated as trading profit and if the object is to derive income by way of dividend then the profit would be said to have accrued from investment. To this extent, the High Court may be correct. At the same time, we do not agree with the test of dominant intention applied by the Punjab and Haryana High Court, which we have already discarded. In that event, the question is as to on what basis those cases are to be decided where the shares of other companies are purchased by the assesseees as 'stock-in-trade' and not as 'investment'. We proceed to discuss this aspect hereinafter.

39. In those cases, where shares are held as stock-in-trade, the main purpose is to trade in those shares and earn profits therefrom. However, we are not concerned with those profits which would naturally be treated as 'income' under the head 'profits and gains from business and profession'. What happens is that, in the process, when the shares are held as 'stock-in-trade', certain dividend is also earned, though incidentally, which is also an income. However,

by virtue of Section 10 (34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section 14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income as held in *Walfort Share and Stock Brokers P Ltd.* case. Therefore, to that extent, depending upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned.”

18.2. Thus in the above judgment, it is held by the Hon’ble Supreme Court that “if expenditure is incurred on earning dividend income, that much of the expenditure which is attributable to dividend income has to be disallowed and cannot be treated as business expenditure. In those cases, where shares are held as stock-in-trade, main purpose is to trade in those shares and earn profits therefrom, in the process, certain dividend is also earned, though incidentally, which is also an income. This triggers applicability of section 14A which is based on theory of apportionment of expenditure between taxable and non-taxable income. Therefore, to that extent, expenditure incurred in acquiring those shares will have to be apportioned.”

18.3 In view of the above ratio clearly laid down by the Hon’ble Supreme Court, we don’t feel the necessity of referring to the order of the Tribunal in *Nice Bombay Transport P. Ltd.* (supra) and *Punjab National Bank* (supra) relied on by the Ld. counsel.

18.4 In *Vireet Investment (P.) Ltd.* (supra), it is held by the Special Bench of the Tribunal that only those investments are to be considered for

computing average value of investment which yielded exempt income during the year. We are of the considered view that the ratio laid down in the above decision is squarely applicable in the instant case.

Therefore, we set aside the order of the Ld. CIT(A) for the impugned assessment years and restore the matter to the file of the AO to make a *de novo* order after following the ratio laid down in *Vireet Investment (P.) Ltd.*(supra). We direct the assessee to file the relevant documents/evidence before the AO. Needless to say, the AO would give a reasonable opportunity of being heard to the assessee before finalizing the order.

19. In the result, the appeals are partly allowed for statistical purposes.

Order pronounced in the open Court on 16/10/2019.

Sd/-
(C.N. PRASAD)
JUDICIAL MEMBER

Sd/-
(N.K. PRADHAN)
ACCOUNTANT MEMBER

Mumbai;

Dated: 16/10/2019

Rahul Sharma, Sr. P.S.

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A)-
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Assistant Registrar)
ITAT, Mumbai