

आयकर अपीलिय अधिकरण, 'बी' न्यायपीठ, चेन्नई  
**IN THE INCOME TAX APPELLATE TRIBUNAL**  
'B' BENCH, CHENNAI

श्री धुव्वुरु आर.एल रेड्डी ,न्यायिक सदस्य एवं श्री जीमंजुनाथ ., लेखा सदस्य के समक्ष  
**BEFORE SHRI DUVVURU RL REDDY, JUDICIAL MEMBER AND**  
**SHRI G. MANJUNATHA, ACCOUNTANT MEMBER**

आयकर अपील सं./**ITA No.:3537/CHNY/2018**

निर्धारण वर्ष / Assessment Year: 2010-11

**The JCIT,**  
Corporate Circle – 2(2),  
Chennai – 34.

**M/s. Healkraft Pharma**  
**(India) Pvt. Ltd.,**  
v. No.22, Old No.56, 1A,  
Owners Court, Montieth Lane,  
Egmore, Chennai – 600 008.

**PAN: AAACH 5487R**

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

&

आयकर अपील सं./**ITA No.:3345/CHNY/2018**

निर्धारण वर्ष / Assessment Year: 2010-11

**M/s. Healkraft Pharma (India)**  
**Pvt. Ltd.,**  
No.22, Old No.56, 1A,  
Owners Court, Montieth Lane,  
Egmore, Chennai – 600 008.

**The JCIT,**  
v. Corporate Circle – 2(2),  
Chennai – 34.

**PAN: AAACH 5487R**

(अपीलार्थी/Appellant)

(प्रत्यर्थी/Respondent)

राजस्व की ओर से /Revenue by  
निर्धारिती की ओर से/Assessee by

: Shri G. Johnson, Addl.CIT  
: Shri T. Banusekar, CA

सुनवाई की तारीख/Date of Hearing

: 30.08.2021

घोषणा की तारीख/Date of Pronouncement

: 08.09.2021

**आदेश / O R D E R****Per G Manjunatha, AM:**

These cross appeals filed by the assessee and Revenue are directed against order of learned Commissioner of Income Tax (Appeals) – 6, Chennai, dated 11.09.2018 and pertains to assessment year 2010-11. Since, facts are identical and issues are common, for the sake of convenience, these appeals are heard together and are being disposed off, by this consolidated order.

**2. The assessee has raised the following grounds of appeal:-**

1. For that the order of the Commissioner of Income Tax (Appeals) is contrary to law, facts and circumstances of the case and is opposed to the principles of equity, natural justice and fair play.
2. For that the Commissioner of Income Tax (Appeals) failed to appreciate that the order of the Assessing Officer is without jurisdiction.
3. For that the Commissioner of Income Tax (Appeals) erred in upholding the disallowance of sales promotion expenses made by the Assessing Officer amounting to Rs.1,18,67,354/- uls.37(1).
4. For that the Commissioner of Income Tax (Appeals) failed to appreciate that the Indian Medical Council (Professional conduct, Etiquette and Ethics) regulations 2002, only restricts a medical practitioner from receiving any gift from any pharmaceutical or allied health care industry.
5. For that the Commissioner of Income Tax (Appeals) failed to appreciate that there is no prohibition on the pharmaceutical industry from giving freebies and gifts to distributors and retailers.

6. For that the Commissioner of Income Tax (Appeals) failed to appreciate that the CBDT Circular No.5/2012 dated 01.08.2012 is contrary to law.

7. For that the Commissioner of Income Tax (Appeals) failed to appreciate that the gifts were not given to any medical practitioner and were only given to the distribution centres of appellant's principal.

8. For that without prejudice to the contention that the sales promotion expenses cannot be disallowed u/s.37(1), the disallowance should have been restricted to freebies and gifts received by medical practitioners.

9. For that the Commissioner of Income Tax (Appeals) erred in concluding that there is no nexus between the incurring of the said expenditure with that of the nature of the business carried on by the appellant and consequently upholding the disallowance of the said expenditure.

10. For that the Commissioner of Income disallowance of Rs.3,67,943/- u/s.14A.

11. For that the Commissioner of Income Tax (Appeals) failed to appreciate that the provisions of section 14A read with and circumstances of the case.

12. For that the Commissioner of Income Tax (Appeals) failed to appreciate that there is no satisfaction of the Assessing Officer that any expenditure was in fact incurred so as to attract the provisions of section 14A read with Rule 8D.

13. For that without prejudice to the above, the Commissioner of Income Tax (Appeals) failed to appreciate that the borrowed funds were not utilized for making investments.

14. For that the Commissioner of Income Tax (Appeals) failed to appreciate that disallowance u/s.14A read with Rule 8D was not warranted as no expenditure was incurred by the appellant for earning exempt income.

15. For that the Commissioner of Income Tax (Appeals) failed to appreciate that investment not yielding exempt income has to be excluded for the purpose of computing disallowance under limbs (ii) and (iii) of Rule 8D.

16. For that the Commissioner of Income Tax (Appeals) erred in confirming a sum of Rs.2,00,673/- as expenditure directly relating to income which does not form part of total income while computing the disallowance u/s.14A read with Rule BD.

17 .For that the appellant objects to the levy of interest u/s 234B and 234C.

3. The Revenue has raised the following grounds of appeal:-

1.1 The Order of the learned Commissioner of Income Tax (Appeals) is contrary to the Law and facts of the case.

2.1 The CIT(A) erred in allowing the deduction u/s.80IC and holding that the expenditure on sales promotion and advertisement and publicity expenses were incidental to the manufacturing activities.

3.1 The CIT(A) erred in directing the AO to delete the disallowance made u/s.14A r.w.r. 8D(2)(ii), if the assessee's own funds are more than investments made in tax free investments, when there is no such exception provided in Rule 8D.

3.2 The CIT(A) ought to have considered the CBDT circular No.5/2014 wherein it is clarified that, disallowance u/s.14A r.w.r.8D has to be made even if the taxpayer in a particular year not earned any exempt income.

4. For these and other grounds that may be adduced at the time of hearing, it is prayed that the Order of the learned Commissioner of Income Tax (Appeals) be set aside and that of the Assessing Officer be restored.

4. The brief facts of the case are that the assessee company is engaged in the business of manufacture and export of pharmaceuticals and allied products, filed its return of income for the assessment year 2010-11 on 28.09.2010, declaring 'nil' total income after claiming deduction u/s.80IC of the Income Tax Act,

1961 (hereinafter the 'Act'). The assessment for the impugned assessment year has been computed u/s.143(3) of the Act on 05.02.2013 and determined total income at Rs.1,87,40,468/- by making additions towards disallowance u/s.14A r.w.rule 8D of Income Tax Rules, 1962 (hereinafter the 'IT Rules') for Rs.3,67,943/- and disallowance of sales promotion expenses u/s.37(1) of the Act, for Rs.1,18,67,354/- and further recomputed deduction claimed u/s.80IC of the Act by excluding income relatable to marketing activity of Rs.1,89,90,584/-. The AO had also recomputed book profit u/s.115JB of the Act by adding disallowance u/s.14A r.w.rule 8D of IT Rules for Rs.3,67,943/-. The assessee carried the matter in appeal before the first appellate authority. The Id.CIT(A) for the reasons stated in her appellate order dated 11.09.2018 partly allowed the appeal filed by the assessee, where she has allowed partial relief in respect of disallowance of sales promotion expenses made by the AO towards cost incurred on free samples to physicians of Rs.71,23,230/-, but confirmed addition made by the AO towards sales promotion expenses incurred for distribution of free samples to medical practitioners. The Id.CIT(A) has also allowed partial relief towards disallowance u/s.14A r.w.rule 8D, where she had sustained addition made by the AO under Rule 8D(2)(i) & (iii), however directed the AO to recompute disallowance

under Rule 8D(2)(ii) after verification of claim of the assessee regarding availability of own funds. Aggrieved by the CIT(A) order, the assessee as well as the Revenue are in appeal before us.

5. The first issue that came up for our consideration from both the appeals is disallowance of sales promotion expenses and re-working of deduction u/s.80IC of the Act. The facts with regard to the impugned dispute are that the assessee is engaged in the business of manufacture and export of pharmaceutical products, had marketed its products through M/s. Tablets India Ltd. The assessee had entered into an exclusive marketing agreement with M/s. Tablets India Ltd., as per which part of sales promotion advertisement, publicity expenses incurred has been reimbursed by the assessee. The AO has disallowed marketing expenses incurred by the assessee on two grounds. According to the AO, when the assessee is not marketing its products on its own, the necessity of incurring sales promotion and publicity expenses does not arise. Therefore, he opined that expenditure incurred towards publicity and sales promotion is not wholly and exclusively incurred for the purpose of business of the assessee. The AO had also disallowed said expenditure under proviso to Section 37(1) of the Act, on the ground that Medical Council of India prohibited distribution of

freebies to doctors and thus, any expenditure incurred towards freebies to doctors is in violation of proviso to Section 37(1) of the Act and hence, not allowable as deduction. Further, the AO has recomputed deduction claimed u/s.80IC of the Act, by reducing income pertains to marketing activity including sales promotion expenses and free samples given to the medical practitioners. On appeal, the Id.CIT(A) has allowed partial relief, where she had confirmed disallowance of sales promotion expenses on the ground that the assessee has not established nexus between expenditure and business activity, however allowed relief in respect of free samples given to medical practitioners.

6. The Id.AR for the assessee submitted that this issue is squarely covered in favour of the assessee by the decision of ITAT in assessee's own case for the assessment year 2012-13 in ITA No.2755/Chny/2018, where the Tribunal after considering circular issued by Medical Council of India and also the CBDT circular No.5 of 2012, held that guidelines issued by Medical Council of India on medical practitioners is not applicable to the assessee, which is manufacturing pharmaceutical products. The Id.AR further submitted that the Tribunal had also considered circular issued by CBDT and held that said circular is applicable from assessment year

2013-14 onwards. Since, the issue in question pertains to assessment year 2010-11, application of CBDT circular No.5 of 2012 to make disallowances is incorrect. The Id.AR further referring to Para 2.8 of Tribunal order submitted that the Tribunal had also considered the issue of deductibility of enhanced profit on account of disallowance of expenditure u/s.80IC of the Act and by following the decision of Hon'ble Bombay High Court in the case of CIT vs. Gem Plus Jewellery India Ltd., 330 ITR 175 held that enhanced profit on account of disallowance of expenses is eligible for deduction u/s.80IC of the Act.

7. The Id.DR on the other hand submitted that the CIT(A) has erred in allowing deduction u/s.80IC of the Act, without appreciating the fact that there is no nexus between sales promotion expenses incurred by the assessee and business activity, because the assessee is not marketing its products on its own. Therefore, question of allowing sales promotion expense does not arise.

8. We have heard both the parties, perused materials available on record and gone through orders of the authorities below. An identical issue had been considered by Tribunal in assessee's own case for assessment year 2012-13 in ITA No.2755/Chny/2018,

where the Tribunal by following various decisions including decision of Mumbai Tribunal in the case of Macleods Pharmaceuticals Ltd., vs. Addl.CIT, 161 ITD 291 and also circular issued by CBDT vide Circular No.5 of 2012, held that sales promotion expenditure incurred by an assessee in the business of manufacture and selling of pharmaceutical products cannot be disallowed by enlarging the scope of circular issued under different regulation. The relevant findings of the Tribunal are as under:-

“2.2. We have heard the rival submissions and perused the materials available on record. We find that the assessee is a manufacturer of pharmaceutical products. The various arguments of the Id AR could be summarized as under:-

a) The assessee, who is a manufacturer of pharmaceutical products had marketed its products through Tablets (India) Ltd. Based on an agreement with Tablets (India) Ltd, the assessee had accepted to share a part of the sales promotion, advertisement and publicity expenses. It is a commercial decision taken by the assessee and the same cannot be questioned by the revenue. The Id AR relied on the decisions of the Hon'ble Supreme Court in the case of S.A.Builders Ltd V. CIT reported in 288 ITR 1 (SC) and in the case of Hero Cycles (P) Ltd V. CIT reported in 379 ITR 347 (SC) and also the decision of Hon'ble Delhi High Court in the case of CIT V. Dalmia Cement (Bharat) Ltd reported in 254 ITR 377 (Del), wherein it was held that the assessee's nexus between the expenditure and the purpose of the business had to be looked into from the point of view of businessman and not from the point of the revenue. The Id AO cannot step into the shoes of the assessee to decide whether the expenditure is required to be incurred by the assessee or not.

b) The ld AR stated that the CBDT Circular No.5 / 2012 which the ld AO relied on to hold the expenditure incurred by the assessee is an offence is dated 01.08.2012 and hence the same would not be applicable to the impugned assessment year i.e. AY 2012-13. In support of this proposition, he relied on the co-ordinate bench decision of Mumbai Tribunal in the case of Macleods Pharmaceuticals Ltd V. Additional CIT reported in 161 ITD 291 and Syncom Formulations (I) Ltd V. DCIT in ITA No.6429 / Mum / 2012, wherein it has been held that the Circular was introduced w.e.f. 01.08.2012 and hence effective from assessment year 2013-14 onwards.

c) The ld AR also stated that the assessee company had not distributed the freebies namely DVD players and silver coins to any medical practitioner but only to Tablets (India) Ltd which is marketing the assessee's products and hence the said expenditure would not be covered by Circular No.5 / 2012 of the CBDT.

d) The ld AR by placing reliance on the co-ordinate bench decision of Mumbai Tribunal in the case of Solvay Pharma India Ltd V. PCIT reported in 169 ITD 13 , submitted that the Indian Medical Council (Professional Conduct Etiquette and Ethics) Regulations, 2002 is applicable only to the medical practitioners and not to the Pharma companies and further that the CBDT cannot enlarge the scope and applicability of "Indian Medical Council Regulation 2002" by making it applicable to the pharmaceutical companies.

e) The ld AR in support of Additional Ground No.13 raised by the assessee claimed that the expenditure disallowed by the Assessing Officer goes to increase the gross profit of the assessee and that the same is eligible for deduction u/s.80IC. In support of this proposition, he placed reliance on the decision of Hon'ble Bombay High Court in CIT V. Gem Plus Jewellery India Ltd reported in 330 ITR 175 (Bom). He also placed placed reliance on the CBDT Circular No.37 / 2016 dated 02.11.2016 where it has been stated as follows:-

*"3. In view of the above, the Board has accepted the settled position that the disallowances made under sections 32, 40(a)(ia), 40A(3), 43B, etc. of the Act and other specific*

*disallowances, related to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced by the disallowance.”*

2.3. Per Contra, the ld DR vehemently argued that the expenditure incurred by the assessee is in violation of the provisions of section 37(1) and that they are hit directly by the CBDT Circular No.5 of 2012 and accordingly the said expenditure is not eligible for deduction u/s 37(1) of the Act. He also argued that the CBDT Circular needs to be extended to Pharma companies also as it is the paying hands (i.e the persons distributing the various gifts etc) and the medical practitioners are the receiving hands ( i.e the persons receiving the various gifts etc). Hence there is no need to segregated between two parties and that the Circular should be read in totality.

2.4. We find that the expenditure incurred by the assessee towards sales promotion, advertisement and publicity expenses were incurred in line with the business of the assessee and that the revenue had not doubted the genuineness of the incurring of such expenditure. We find that the only grievance of the revenue is that the assessee need not have incurred that expenditure (i.e getting into the propriety of a transaction) and further the said expenditure is hit by the CBDT Circular No.5 / 2012. It is well settled that the revenue cannot step into the shoes of the assessee to decide whether the expenditure is required to be incurred by the assessee or not where the genuineness of the same is not questioned. The ld AO has to see whether the particular expenditure incurred is not personal in nature , is not capital in nature and incurred wholly and exclusively for the purpose of business of the assessee. When assessee is able to provide the business nexus of incurrence of certain expenditure with supporting documents, it cannot be simply denied / rejected by the revenue merely on the ground of propriety, which action would lead to, travelling beyond the brief and stepping into the shoes of the assessee by the revenue. The various apex court decisions relied upon by the ld AR supra clearly point out this ratio. We therefore hold

that the expenditure incurred by the assessee towards sales promotion, advertisement and publicity is an allowable expenditure.

2.5. It is not in dispute that the assessee had only distributed the DVD players, silver coins, calenders and diaries to Tablets India Ltd which was marketing the products of the assessee. There was absolutely no distribution of gifts made by assessee to any medical practitioners and hence the applicability of CBDT Circular No. 5/2012 itself deserves to be rejected. Reliance in this regard had been rightly placed on the co-ordinate bench decision of Mumbai Tribunal in Solvay Pharma India Ltd V. PCIT 169 ITD 13 wherein it was held as follows:-

*“23. Now coming to the Explanation to Section 37(1) invoked by the CIT, the Explanation provides an embargo upon allowing any expenditure incurred by the assessee for any purpose which is an offence or which is prohibited by law. This means that there should be an offence by an assessee who is claiming the expenditure or there is any kind of prohibition by law which is applicable to the assessee. Here in this case, no such offence of law has been brought on record, which prohibits the pharmaceutical company not to incur any development or sales promotion expenses. A law which is applicable to different class of persons or particular category of assessee, same cannot be made applicable to all. The regulation of 2002 issued by the Medical Council of India (supra), provides limitation/curb/prohibition for medical practitioners only and not for pharmaceutical companies. Here the maxim of 'ExpressioUniusEstExclusioAlterius' is clearly applicable, that is, if a particular expression in the statute is expressly stated for particular class of assessee then by implication what has not been stated or expressed in the statute has to be excluded for other class of assessee. If the Medical Council regulation is applicable to medical practitioners then it cannot be made applicable to Pharma or allied health care companies. If section 37(1) is applicable to an assessee claiming the expense then by implication, any impairment caused by Explanation 1 will apply to that assessee only. Any impairment or prohibition by any law/regulation on a different*

*class of person/assessee will not impinge upon the assessee claiming the expenditure under this section.*

*24. We observe that the CBDT Circular dated 1-8-2012 (supra) in its clarification has enlarged the scope and applicability of 'Indian Medical Council Regulation 2002' by making it applicable to the pharmaceutical companies or allied health care sector industries. Such an enlargement of scope of MCI regulation to the pharmaceutical companies by the CBDT is without any enabling provisions either under the provisions of Income Tax Law or by any provisions under the Indian Medical Council Regulations. The CBDT cannot provide casus omissus to a statute or notification or any regulation which has not been expressly provided therein. The CBDT can tone down the rigours of law and ensure a fair enforcement of the provisions by issuing circulars and by clarifying the statutory provisions. CBDT circulars act like 'contemporaneaexpositio' in interpreting the statutory provisions and to ascertain the true meaning enunciated at the time when statute was enacted. However the CBDT in its power cannot create a new impairment adverse to an assessee or to a class of assessee without any sanction of law. The circular issued by the CBDT must confirm to tax laws and for purpose of giving administrative relief or for clarifying the provisions of law and cannot impose a burden on the assessee, leave alone creating a new burden by enlarging the scope of a different regulation issued under a different act so as to impose any kind of hardship or liability to the assessee. In any case, it is trite law that the CBDT circular which creates a burden or liability or imposes a new kind of imparity, same cannot be reckoned retrospectively. The beneficial circular may apply retrospectively but a circular imposing a burden has to be applied prospectively only. Here in this case the CBDT has enlarged the scope of 'Indian Medical Council Regulation, 2002' and made it applicable for the pharmaceutical companies. Therefore, such a CBDT circular cannot be reckoned to have retrospective effect.....”*

2.6. We hold that the Circular issued by the CBDT cannot enlarge the scope of a different regulation issued under a different act so as to impose any kind of hardship or liability to the assessee.

2.7. We further hold that Circular No.5 / 2012 is effective only from 01.08.2012 (i.e from Asst Year 2013-14 onwards) as held by the Mumbai Tribunal in Macleods Pharmaceuticals Ltd referred to *supra*. Hence the same would not be applicable to the impugned assessment year i.e AY 2012-13 and hence disallowance cannot be made based on the said Circular. We therefore, direct the ld AO to allow the claim of sales promotion, advertisement and publicity expenses u/s.37 of the Act. “

8.1 As regards, re-computation of deduction claim u/s.80IC of the Act, by excluding disallowance made towards sales promotion and publicity expenses including free samples given to medical practitioners, the Tribunal by following the decision of Hon'ble Bombay High Court in the case of CIT vs. Gem Plus Jewellery India Ltd., *supra*, held that enhanced profit on account of disallowance of expenses is eligible for deduction u/s.80IC of the Act. The relevant findings of the Tribunal are as under:-

“2.8. Now let us come to the Additional Ground raised by the assessee on the aspect of whether the disallowance of aforesaid expenditure would correspondingly go to increase the claim of deduction u/s 80IC of the Act. We find that this is a legal claim made by the assessee which could be raised for the first time before this tribunal and accordingly deem it fit to admit the same and take up for adjudication. The issue of whether deduction u/s.80IC of the Act should be computed on the profits as increased by the disallowance u/s.37(1) of the Act is covered in favour of the assessee by the

decisions in CIT V.Gem Plus Jewellery India Ltd 330 ITR 175 (Bom) and DCIT V. Vertex Infosoft Solution (P) Ltd 37 ITR (Trib) 521. Further it would be pertinent to hold that the issue now stands settled by the CBDT Circular No.37 / 2016 dated 02.11.2016 where the Board had clarified that the deduction under Chapter VI-A will be on such profits including disallowance under sections 32, 40(a)(ia), 40A(3), 43B etc of the Act which will include disallowance made u/s.37(1) as well.

2.9. We also find from the computation of income made by the Id AO, that the Id AO had disallowed the entire Sales promotion, advertisement and publicity expenses u/s 37(1) of the Act separately. Further he had again reduced the claim of deduction u/s 80IC of the Act by the very same amount of sales promotion, advertisement and publicity. This would effectively result in double disallowance made by the Id AO which we direct the Id AO to rectify.”

8.2 In this view of matter and consistent with view taken by the Co-ordinate Bench, we are of the considered view that the AO as well as the Id.CIT(A) were erred in disallowing sales promotion expenses u/s.37(1) of the Act, by considering guideline issued by the Medical Council of India under different legislation. Hence, we direct the AO to delete addition made towards disallowance of sales promotion and publicity expenses and further, allow deduction claim u/s.80IC of the Act, without reducing disallowance made towards sales promotion and publicity expenses.

9. The next issue that came up for our consideration from both the appeals is disallowance u/s.14A r.w.rule 8D of the IT Rules. The

facts with regard to the impugned dispute are that the assessee has received dividend income of Rs.4,91,788/- and claimed exemption u/s.10(34) of the Act. The assessee has not made *suo-moto* disallowance of expenditure relatable to exempt income. Therefore, the AO has invoked provisions of rule 8D of IT Rules and computed disallowance of Rs.3,67,943/-. On appeal, the Id.CIT(A) has confirmed disallowance made by the AO towards direct expenditure under Rule 8D(2)(i) and other expenses under Rule 8D(2)(iii), but set aside disallowance of interest expenditure under Rule 8D(2)(ii) to verify the claim of the assessee with regard to availability of own funds.

10. The Id.AR for the assessee submitted that the Id.CIT(A) has erred in upholding disallowance u/s.14A r.w.rule 8D of IT Rules without appreciating the fact that the AO has not recorded satisfaction as required u/s.14A(2) of the Act having regard to books of accounts of the assessee that claim of the assessee that no expenditure has been incurred to earn exempt income is incorrect. The Id.AR further submitted that the Id.CIT(A) has erred in sustaining addition made by the AO towards direct expenses under Rule 8D(2)(i) and other expenses under Rule 8D(2)(iii) ignoring the fact that no expenditure was incurred by the assessee for earning

exempt income. He further submitted that as regards interest expenditure, the assessee has sufficient own funds which is in excess of investments made in shares and securities which yielded exempt income and thus, interest expenses cannot be disallowed.

11. The Id.DR on the other hand submitted that the Id.CIT(A) has erred in directing the AO to delete disallowance made u/s.14A r.w.rule 8D(2)(ii) without appreciating the fact that there is no exception provided under Rule 8D to exclude interest expenses, if assessee proves availability of own funds.

12. We have heard both the parties, perused materials available on record and gone through orders of the authorities below. As regards arguments of the Id.AR for the assessee on the issue of satisfaction as required u/s.14A(2) of the Act, we find that the Hon'ble Supreme Court in the case of Maxopp Investment Ltd vs. CIT, 402 ITR 640 has settled the controversy, where it has been clearly held that the issue of satisfaction comes into play only when the assessee has made *suo-motto* disallowance of expenses relatable to exempt income, but the AO did not accept disallowance made by the assessee. In this case, the assessee has not made any *suo-motto* disallowance of expenses and hence, the question of

recording satisfaction as required u/s.14A(2) of the Act does not arise. As regards, disallowance of direct expenses, the AO has given categorical finding towards expenses directly relatable to earning exempt income which does not form part of total income. According to the AO, the assessee has incurred Rs.2,00,673/- which is directly relatable to exempt income. Once there is a categorical finding from the authorities on direct nexus between expenditure incurred for earning exempt income, said expenditure needs to be disallowed under Rule 8D(2)(i) of IT Rules. Therefore, there is no error in the orders of the lower authorities in disallowing direct expenses relatable to exempt income.

12.1 As regards disallowance of interest expenditure, it was the claim of the assessee that it has sufficient interest free funds in excess of investments made in shares and securities, which yielded exempt income. It is a well settled principle of law by the decisions of various High Courts including the decision of Hon'ble Bombay High Court in the case of CIT vs. HDFC Bank Ltd., (2014) 366 ITR 505, where it was clearly held that if assessee had mixed funds including borrowed funds then, general presumption comes in favor of the assessee that investment in shares and securities is out of interest free funds. In this case, the Id.CIT(A) has accepted the

plea of the assessee and has directed the AO to examine availability of interest free funds. Therefore, we are of the considered view that there is no error in the findings recorded by the Id.CIT(A) to restore the issue to the file of the AO and to determine disallowance of interest expenses under Rule 8D(2)(ii), on the basis of availability of interest free funds.

12.2 As regards disallowance of other expenses under Rule 8D(2)(iii) at the rate of 0.5% of average value of investments, when the assessee has not made any suo-motto disallowance towards expenses relatable to exempt income, then the AO left with no option but to apply prescribed procedure provided under Rule 8D(2)(iii) of the IT Rules. Hence, there is no error in disallowance made by the AO towards other expenses. Accordingly, we reject the ground taken by the assessee.

12.3 As regards excluding investments which does not yield exempt income, we find that it is a well settled principle of law by the decision of ITAT, Special Bench in the case of ACIT vs. Vireet Investment Pvt. Ltd., 165 ITD 27, where it was clearly held that only those investments which yielded exempt income for the relevant assessment year needs to be considered for the purpose of

disallowance of other expenses under Rule 8D(2)(iii) of IT Rules. Therefore, we direct the AO to consider only those investments which yielded exempt income for the purpose of computing average value of investments and further to disallow other expenses at the rate of 0.5% of average value of investments.

13. In the result, the appeal filed by the assessee is partly allowed and the appeal filed by the Revenue is dismissed.

Order pronounced in the court on 8<sup>th</sup> September, 2021 at Chennai.

Sd/-  
(धुव्वुरु आर.एल रेड्डी)  
(Duvvuru RL Reddy)  
न्यायिक सदस्य/Judicial Member

Sd/-  
(जी. मंजुनाथ)  
(G. Manjunatha)  
लेखा सदस्य /Accountant Member

चेन्नई/Chennai,  
दिनांक/Dated, the 8<sup>th</sup> September, 2021

**RSR**

- |                        |                         |                              |
|------------------------|-------------------------|------------------------------|
| 1. निर्धारिती/Assessee | 2. राजस्व/Revenue       | 3. आयकर आयुक्त (अपील)/CIT(A) |
| 4. आयकर आयुक्त /CIT    | 5. विभागीय प्रतिनिधि/DR | 6. गार्ड फाईल/GF.            |