IN THE INCOME TAX APPELLATE TRIBUNAL
LUCKNOW BENCH 'A', LUCKNOW

BEFORE SHRI A. D. JAIN, VICE PRESIDENT AND
SHRI T. S. KAPOOR, ACCOUNTANT MEMBER

ITA No.255/Lkw/2015
Assessment Year:2009-10
&
I.T.A. No.928/Lkw/2014
Assessment year:2010-11

M/s Kothari Products Ltd., 24/19, The Mall, Kanpur. PAN:AAACK5571F	Vs.	A.C.I.T., Central Circle-1, Kanpur.
(Appellant)		(Respondent)

Appellant by	Shri Abhinav Mehrotra, Advocate
Respondent by	Shri Ajay Kumar, D.R.
Date of hearing	14/09/2021
Date of pronouncement	20/10/2021

O R D E R

PER T. S. KAPOOR, A.M.

These two appeals have been filed by the assessee against the separate orders of learned CIT(A) dated 20/09/2014 and 16/01/2015 respectively.

2. These appeals were earlier dismissed by the Tribunal vide order dated 24/07/2015 and 12/01/2016 respectively. Since these Tribunal orders were passed ex-parte qua assessee, therefore, these were recalled for hearing afresh vide Tribunal order dated 27/05/2016 and 09/06/2017 respectively and now these appeals have been listed for hearing on merits.

3. The assessee has taken similar grounds in both the appeals. For the sake of completeness, the grounds of appeal in I.T.A. No.255/Lkw/2015 are reproduced below:

"1. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in upholding disallowance of Rs.26,27,592.00 out of travelling expenses, without appreciating that the entire expense incurred under the head was wholly and exclusively and in the regular course of the appellant's business.

2. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in upholding the disallowance out of traveling expenses without appreciating the fact that the Ld. A.O. had duly examined the business expediency and allowed traveling expenses of the Managing and executive director of the company for the very same trips. Therefore the fact that the overseas trips were in fact business trips was not in dispute.

3. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in not appreciating that the appellant was a listed company, an artificial judicial person, and incapable of any personal or non business expenditure.

4. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in not considering the fact that the said expenses were also covered under the provisions of Chapter XII-H Fringe Benefits Tax and hence tax had duly been paid in respect of the same and therefore "disallowance of the expense resulted in double taxation of the same expense.

5. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in upholding the disallowance of Rs.62,08,794.00 made by the Ld. AO u/s 4A r.w. Rule 8D, when in fact the appellant had suo moto worked out the disallowance u/s 14A and added the same to its income.

6. That the Ld.CIT(A)-!, Kanpur erred in law as well as on facts in not appreciating the fact that in terms of Section 14A(2), the AO ought to record his satisfaction for rejecting an assessee's claim, prior to working out disallowance in accordance with Rule 8D.

7. That the Ld. CIT(A)-I, Kanpur erred in law as well as on facts in upholding the disallowance u/s 14A without considering the fact the Ld. A.O. did not bring on record any reason For rejecting the appellant's calculation of disallowance u/s 14A.

8. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in upholding the disallowance made by the Ld. AO u/s 14A of the Act without appreciating the fact that most of the investments were old investments, and had been made out of surplus funds available with the appellant and no part of the interest bearing funds had been diverted towards the same.

9. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in upholding the disallowance made by the Ld. AO u/s 14A of the Act without examining the veracity of the amount added back by the appellant u/s 14A of the Act.

10. That the Ld.CIT(A)-I, Kanpur erred in law as well as on facts in upholding the disallowances made by the Ld. A.O. without considering the facts and submissions placed on record by the appellant."

4. From the grounds of appeal, it emerges that there are two issues involved in these appeals, which relate to disallowance of travelling expenses and disallowance u/s 14A read with Rule 8D of the I.T. Rules.

4.1 As regards the first issue regarding disallowance of travelling expenses, Learned counsel for the assessee submitted that the Directors of the assessee had travelled beyond the country along with their spouses for the purpose of business and the Assessing Officer and learned CIT(A) have made the disallowances on account of expenses incurred on the spouses of the Directors of the assessee company. It was submitted that the said expenses were incurred by the assessee company as part of the remuneration package of Directors which included besides other things, the travelling expenses also and in this respect our attention was invited to the copy of resolution passed in the meeting of Board of Directors wherein the

Leave Travel Concession was stated to be part of the overall remuneration of the Directors and therefore, it was submitted that such expenditure was part of remuneration of Directors and was allowable as business expenditure. Without prejudice, it was submitted that the assessee had also paid fringe benefit tax on such benefits extended to the Directors and therefore, the further disallowance by the Assessing Officer, amounts to double taxation of the same income which is not permissible under the provisions of law.

4.2 As regards the other disallowance relating to the provisions of section 14A, read with Rule 8D, Learned counsel for the assessee submitted that the assessee itself had worked out the disallowance u/s 14A, read with Rule 8D, and the Assessing Officer, without rejecting the claim of the assessee and without recording his satisfaction for rejecting the assessee's claim, proceeded to make disallowance as per Rule 8D of the I.T. Rules. It was submitted that in various judgments of Hon'ble High Courts and Tribunals, it has been held that before rejecting the claim of the assessee with respect to disallowance u/s 14A, the Assessing Officer is required to record his satisfaction as to why the claim made by the assessee is not tenable. Learned counsel for the assessee further submitted that assessee itself had made disallowance with respect to the expenses and as regards the disallowance out of interest expenses, Learned counsel for the assessee submitted that the assessee had surplus interest free funds at its disposal and therefore, there was mixed use of funds for making investment out of which tax free income was earned and therefore, in view of the recent judgment of Hon'ble Supreme Court in the case of South Indian Bank Ltd. vs. CIT, Civil Appeal No. 9606 of 2011, no disallowance was warranted out of interest expenses. In view of the above facts and circumstances and

judicial precedents, it was argued that the appeals filed by the assessee may be allowed.

5. Learned D. R., on the other hand, submitted that the expenses incurred on the travelling of spouse cannot form part of the business expenditure and the assessee has also not been able to demonstrate as to how the expenses on spouse can be attributed to the business of the assessee. Further it was submitted that the copy of resolution, filed by the assessee, was not part of the record before the authorities below therefore, it was prayed that the matter may be set aside to the Assessing Officer for readjudication in view of fresh evidence.

5.1 As regards the disallowance u/s 14A, read with Rule 8D of the I.T. Rules, learned D.R. submitted that in view of the judgment of Hon'ble Supreme Court, relied on by Learned counsel for the assessee, this issue may also be set aside to the Assessing Officer, who, in accordance with the guidelines of Hon'ble Supreme Court, should work out the disallowance u/s 14A, if any.

6. Learned counsel for the assessee, submitted that though every document is available on record to decide the issue but he is ready to go back to the Assessing Officer for his readjudication on above issues.

7. We have heard the rival parties and have gone through the material placed on record. We find that on the issue of disallowance, out of travelling expenses, Learned counsel for the assessee has filed copy of resolution wherein the reimbursement of travelling expenses in the form of Leave Travel Concession is part of overall remuneration of the Directors and such reimbursement includes expenditure incurred on spouse also. Since the reimbursement to Directors on account of Leave Travel Concession is

not available on the records therefore, it cannot be concluded that the assessee had paid, as a part of remuneration package to Director, any Leave Travel Concession on account of his travel or travel of his spouse. The Assessing Officer has made the disallowance out of travelling expenses which generally do not include the leave travel expenses granted to a Director or employee as such expenses being part of salaries is classified under the head 'remuneration to Directors'. Moreover, the assessee has argued that assessee had paid fringe benefit tax on these perquisites also and above all the assessee had filed copy of resolution mentioning the perquisites of Directors before us. Therefore, in view of all these facts and circumstances, it is appropriate that the matter may be set aside to the Assessing Officer, who in the light of above facts and circumstances, should readjudicate the issue. The assessee is at liberty to file any fresh document in support of its claim.

7.1 As regards the issue of disallowance u/s 14A, we find that assessee had its own funds available as well as had loan funds. The direct linkage of these funds to the investment in investments yielding tax free income needs to be worked out by Assessing Officer. The Hon'ble Supreme Court in South Indian Bank Ltd. (supra) has laid down that if there is mixed use of funds in investment in scrips yielding tax free income then disallowance u/s 14A is not relevant. Paras 23 to 30 of the judgment of Hon'ble Supreme Court are reproduced below:

> *"23. It would now be appropriate to advert in some detail to Maxopp Investment Ltd. v. CIT10. This case interestingly is relied by both sides' counsel. Writing for the Bench, Justice Dr. A.K. Sikri noted the objective for incorporation of Section 14A in the Act in the following words: -*
>
> > *"3……. The purpose behind Section 14-A of the Act, by not permitting deduction of the expenditure incurred*

in relation to income, which does not form part of total income, is to ensure that the assessee does not get double benefit. Once a particular income itself is not to be included in the total income and is exempted from tax, there is no reasonable basis for giving benefit of deduction of the expenditure incurred in earning such an income……..″

The following was written explaining the scope of Section 14-A(1):

"41. In the first instance, it needs to be recognised that as per Section 14-A(1) of the Act, deduction of that expenditure is not to be allowed which has been incurred by the assessee "in relation to income which does not form part of the total income under this Act". Axiomatically, it is that expenditure alone which has been incurred in relation to the income which is includible in total income that has to be disallowed. If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would obviously be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure. To put it differently, such 10 (2018) 15 SCC 523 Page 15 of 22 expenditure would then be considered as incurred in respect of other income which is to be treated as part of the total income."

Adverting to the law as it stood earlier, this Court rejected the theory of dominant purpose suggested by the Punjab & Haryana High Court and accepted the principle of apportionment of expenditure only when the business was divisible, as was propounded by the Delhi High Court. Finally adjudicating the issue of expenditure on shares held as stock-in-trade, the following key observations were made by Justice Sikri: "

50. It is to be kept in mind that in those cases where shares are held as "stock-in-trade", it becomes a business activity of the assessee to deal in those shares as a business proposition. Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk

of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares by selling them to earn profits. The situation here is, therefore, different from the case like Maxopp Investment Ltd. [Maxopp Investment Ltd. v. CIT, 2011 SCC OnLine Del 4855 : (2012) 347 ITR 272] where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the assessee and the assessee alone. Therefore, even at the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is Page 16 of 22 generated that would be earned by the assessee. In contrast, where the shares are held as stockin-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes up in order to earn profits……."

The learned Judge then considered the implication of Rule 8D of the Rules in the context of Section 14-A(2) of the Act and clarified that before applying the theory of apportionment, the Assessing Officer must record satisfaction on Suo Moto disallowance only in those cases where, the apportionment was done by the assessee. The following is relevant for the purpose of this judgment:

51. ……..It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect……."

24. Another important judgment dealing with Section 14A disallowance which merits consideration is Godrej and Boyce Manufacturing Company Ltd. V. DCIT11. Here the assessee had access to adequate interest free funds to make investments and the issue pertained to disallowance of expenditure incurred to earn dividend income, which was not forming part 11 [(2017) 7 SCC 421. Page 17 of 22 of total income of the Assessee. Justice Ranjan Gogoi writing the

opinion on behalf of the Division Bench observed that for disallowance of expenditure incurred in earning an income, it is a condition precedent that such income should not be includible in total income of assessee. This Court accordingly concluded that for attracting provisions of Section 14A, the proof of fact regarding such expenditure being incurred for earning exempt income is necessary. The relevant portion of Justice Gogoi's judgment reads as follow:

> *"36. …… what cannot be denied is that the requirement for attracting the provisions of Section 14-A (1) of the Act is proof of the fact that the expenditure sought to be disallowed/deducted had actually been incurred in earning the dividend income……."*

25. Proceeding now to another aspect, it is seen that the Central Board of Direct Taxes (CBDT) had issued the Circular no. 18 of 2015 dated 02.11.2015, which had analyzed and then explained that all shares and securities held by a bank which are not bought to maintain Statutory Liquidity Ratio (SLR) are its stock-in-trade and not investments and income arising out of those is attributable, to business of banking. This Circular came to be issued in the aftermath of Page 18 of 22 CIT Vs. Nawanshahar Central Cooperative Bank Ltd.12 wherein this Court had held that investments made by a banking concern is part of their banking business. Hence the income earned through such investments would fall under the head Profits & Gains of business. The Punjab and Haryana High Court, in the case of Pr. CIT, vs. State Bank of Patiala13 while adverting to the CBDT Circular, concluded correctly that shares and securities held by a bank are stock in trade, and all income received on such shares and securities must be considered to be business income. That is why Section 14A would not be attracted to such income.

26. Reverting back to the situation here, the Revenue does not contend that the Assessee Banks had held the securities for maintaining the Statutory Liquidity Ratio (SLR), as mentioned in the circular. In view of this position, when there is no finding that the investments of the Assessee are of the related category, tax implication would not arise against the appellants, from the said circular.

27. The aforesaid discussion and the cited judgments advise this Court to conclude that the proportionate disallowance of interest is not warranted, under Section 14A of Income 12 [(2007) 15 SCC 611] / [(2007) 160 TAXMAN 48 (SC)] 13 2017 (393) ITR 476 (P&H) Page 19 of 22 Tax Act for investments made in tax free bonds/ securities which yield tax free dividend and interest to Assessee Banks in those situations where, interest free own funds available with the Assessee, exceeded their investments. With this conclusion, we unhesitatingly agree with the view taken by the learned ITAT favouring the assessees.

28. The above conclusion is reached because nexus has not been established between expenditure disallowed and earning of exempt income. The respondents as earlier noted, have failed to substantiate their argument that assessee was required to maintain separate accounts. Their reliance on Honda Siel (Supra) to project such an obligation on the assessee, is already negated. The learned counsel for the revenue has failed to refer to any statutory provision which obligate the assessee to maintain separate accounts which might justify proportionate disallowance.

29. In the above context, the following saying of Adam Smith in his seminal work – The Wealth of Nations may aptly be quoted:

> *"The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person."*

Echoing what was said by the 18th century economist, it needs to be observed here that in taxation regime, there is no room for presumption and nothing can be taken to be implied. The tax an individual or a corporate is required to pay, is a matter of planning for a tax payer and the Government should endeavour to keep it convenient and simple to achieve maximization of compliance. Just as the Government does not wish for avoidance of tax equally it is the responsibility of the regime to design a tax system for which a subject can budget and plan. If proper balance is

achieved between these, unnecessary litigation can be avoided without compromising on generation of revenue.

30. In view of the forgoing discussion, the issue framed in these appeals is answered against the Revenue and in favour of the assessee. The appeals by the Assessees are accordingly allowed with no order on costs."

8. Since the matter requires verification as to whether the assessee had used mixed funds or had directly utilized interest bearing funds to tax free income yielding assets, we deem it appropriate to remit this issue also back to the Assessing Officer who is directed to work out the disallowance, if any, u/s 14A in accordance with law laid down by Hon'ble Supreme Court in the case of South Indian Bank (supra). Needless to say, the assessee will be afforded fair and reasonable opportunity of being heard. In view of the above facts and circumstances and judicial precedents, the appeals filed by the assessee are allowed for statistical purposes.

9. In the result, both the appeals of the assessee stand allowed for statistical purposes.

(Order pronounced in the open court on 20/10/2021)

Sd/.	**Sd/.**
(A. D. JAIN)	**(T. S. KAPOOR)**
Vice President	**Accountant Member**

Dated:20/10/2021
*Singh

Copy of the order forwarded to :

1. The Appellant
2. The Respondent.
3. Concerned CIT
4. The CIT(A)
5. D.R., I.T.A.T., Lucknow