

**IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE**

**BEFORE SHRI. CHANDRA POOJARI, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

Appeal No.	Appellant	Respondent	Assessment Year
ITA Nos. 1373 & 1374/Bang/2019	The Deputy Commissioner of Income-tax, Circle - 1(1)(2), Bangalore	M/s. Bioplus Life Sciences Pvt. Ltd., No. 10/1A, K.R.Puram, Hoodi Village, Bangalore - 560 048. PAN: AACCB3621R	2012-13 & 2013-14
ITA No. 1254/Bang/2019	M/s. Bioplus Life Sciences Pvt. Ltd., No. 10/1A, K.R.Puram, Hoodi Village, Bangalore - 560 048. PAN: AACCB3621R	The Assistant Commissioner of Income Tax, Circle - 2 (1)(1), Bangalore.	2012-13
ITA No. 1255/Bang/2019		The Income Tax Officer, Ward - 1(1)(1), Bangalore	2013-14

Assessee by	:	Shri Padamchand Khincha, CA
Revenue by	:	Smt. Priyadarshini Besaganni, JCIT (DR)

Date of Hearing	:	28-10-2021
Date of Pronouncement	:	30-12-2021

ORDER

PER BEENA PILLAI, JUDICIAL MEMBER

Present cross appeals are filed by assessee as well as revenue against separate orders dated 07/03/2019 passed by the Ld.CIT(A)-1, Bangalore. It is submitted that the issues raised by assessee and revenue are common in both the assessment years. For sake of convenience we are reproducing the grounds of appeal raised by the assessee as well as revenue for assessment year 2012-13.

ITA No. 1254/Bang/2019

	<i>GROUND OF APPEAL (enclosed separately)</i>	<i>Tax Effect relating to each Ground of appeal</i>
1.	<i>The learned CIT (A) erred in passing the order in the manner which he did.</i>	<i>General</i>
2.	<i>The learned CIT(A) erred in disallowing Product registration expenses without appreciating that same is in nature of capital in nature.</i>	<i>Rs. 31,46,292/-</i>
3.	<i>The learned CIT(A) further ought to have appreciated that Appellant following mercantile method of accounting, the product registration expenses have been charged off in the accounts constitutes as an expenditure allowable u/s 37(1) and hence disallowance is ought to be deleted.</i>	<i>Rs. 31,46,292/-</i>
4.	<i>The learned CIT(A) erred in disallowing expenditure to the tune of Rs. 31,46,292/- without appreciating the submissions of the Appellant</i>	<i>Rs. 31,46,292/-</i>
5.	<i>The learned CIT(A) erred in upholding the interest u/s 234B and 234C of the Act</i>	<i>General</i>
6.	<i>Without prejudice the disallowance as confirmed by the learned CIT (Appeals) are arbitrary excessive and ought to be reduced substantially.</i>	<i>General</i>
7.	<i>For these and such other grounds that may be urged at the time of hearing the Appellant prays that the appeal may be allowed.</i>	<i>General</i>
	<i>TOTAL TAX EFFECT</i>	<i>Rs. 9,43,887/-</i>

ITA No. 1373/Bang/2019

“1. The order of the Learned CIT (Appeals), in so far as it is prejudicial to the interest of revenue, is opposed to law and the facts and circumstances of the case.

2. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs. 1,71,71 503/- made by the Assessing Officer on account of Product Registration Charges though the said expenses are capital in nature.

3. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) erred in deleting the addition of Rs.

14,85,109/- made by the AO u/s 14A of IT Act 1961 read with Rule 8D (2)(ii) of I.T. Rules 1962.

4. For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the Ld. CIT (A) be reversed and that of the Assessing Officer be restored.

5. The appellant craves leave to add, to alter, to amend or delete any of the grounds that may be urged at the time of hearing of appeal.”

2. Brief facts of the case for assessment year 2012-13 are as under:

2.1 The assessee is engaged in the business of manufacture and export of pharmaceuticals and nutraceutical products. The assessee filed its return of income on 29/09/2012 for year under consideration declaring total income of Rs.4,02,55,500/-. The case was selected for scrutiny and statutory notices were issued to assessee in response to which the representatives of assessee appeared before the Ld.AO and filed requisite details as called for.

2.2 Ld.AO on going through the financials of assessee observed that assessee had claimed following:

- Deduction of Provision for bad and doubtful receivables amounting to Rs.5,40,566/-

2.3 The Ld.AO noted that assessee had debited the amount in the Profit & loss account, however, did not disallow the same while computing the income for year under consideration. The Ld.AO accordingly added the sum in the hands of assessee.

- Deduction of product registration expenses amounting to Rs.1,17,71,503/- under the head other expenses.

2.4 The Ld.AO observed that the breakup of product registration expenses reflected in the profit and loss account were as under:

Particulars	Amount(in Rs.)
License Renewal Fee-Dolenio	4,32,597/-
Mutual Recognition Variation	1,25,43,851/-

Expenses- Dolenio	
Patent-Sustained Release Drug Delivery System	29,62,433/-
Patent Expenses- R&D	3,26,277/-
Trademark Expenses-Mktg	13,555/-
Registration Expenses-RA	8,92,790/-
Total	1,17,71,503/-

2.5 The Ld.AO after considering the submissions advanced by assessee held the Product development expenses to be capital expenditure, as assessee did not prove the expenses to be recurring in nature. He relied on the decision of *Hon'ble Supreme Court* in case of *R.B.Seth Moolchand Suganchand Vs.CIT* reported in (1972) 86 ITR 647. The Ld.AO however granted depreciation @ 25 %.

- The Ld.AO observed that assessee had earned exempt free income from mutual funds of Rs.2,03,59,232/-. It was also noted by the Ld.AO that assessee had voluntarily disallowed Rs.18,52,411/- as expenditure under Rule 8D(2)(iii) under read with section 14 A of the Act.

2.6 After considering the submissions advanced by assessee the Ld.AO computed disallowance under section 14A, read with Rule 8(D)(2)(ii) at Rs. 14,85,109/- , thereby computing the disallowance at Rs.33,37,520/-.

Aggrieved by the order of Ld.AO, assessee preferred appeal before the Ld.CIT(A).

The Ld.CIT(A), following the DRP direction passed for assessment year 2014-15, held License renewal fee-Dolenio, Mutual recognition process variation expenses to be revenue in nature and the remaining expenses to be capital in nature.

3. In respect of disallowance computed under R 8(d)(2)(ii), the Ld.CIT(A) observed that assessee had surplus own funds in the

form of share capital and reserve and surplus amounting to Rs.129.35 crores as against the total investment of Rs.34.27 crores. He thus deleted the disallowance computed by the Ld.AO under R 8(d)(2)(ii).

Aggrieved by the order of the Ld.CIT(A), assessee as well as revenue are in appeal before this *Tribunal*.

We note that Grounds 1-4 in assessee's appeal and Ground no.2 in revenue appeal related to product development expenses incurred by assessee whether revenue or capital in nature.

It is submitted that issues could be summarised in the following manner:

S.No.	Particulars	Amount AY:2012-13	Amount AY:2013-14
1.	License Renewal Fee-Dolenio	4,32,597	
2.	Annual Fee- Dolenio		26,46,584
3.	Mutual Recognition Variation 18- Dolenio		10,29,359
4.	Mutual Recognition Variation 19- Dolenio		16,98,036
5.	Mutual Recognition Variation Expenses- Dolenio	1,25,43,851	91,17,371
6.	Patent-Sustained Release Drug Delivery System	29,62,433	4,45,609
7.	Patent Expenses- R&D	3,26,277	60,688
8.	Trademark Expenses-Mktg	13,555	26,33,100
9.	Registration Expenses-RA	8,92,790	10,28,534
10.	Rates & Taxes Product Registration		1,57,541
	Total	1,17,71,503	

4. On perusal of impugned order, we note that for both years under consideration, item number 1-5 has been allowed by the Ld.CIT(A) as revenue expenditure against which revenue is in appeal and item no.6-10 has been upheld to be capital expenditure against which assessee is in appeal.

In general for all these above expenses, the Ld.AR submitted that these are incurred every year by assessee, as has been submitted

before the authorities below. He submitted that the above tabulated payments are in the nature of regulatory payments that are paid by assessee to the foreign Government. He submitted that,

“" Dolenio" related expenses:

" Dolenio" is drug registered and sold by the company, in various countries and the expenses related to this product are:

Annual fee - Dolenio- This is the annual renewal fees payable in various countries to sell the "Dolenio" series products.

Mutual Recognition Process Variation / MRV Expenses - This is the fees paid to the Government for any variation from the registered use or process in the use of raw material or packing material or colours in the final pack or for change in supplier of raw material etc.

License renewal fees - Dolenio- This is an expense incurred for renewal of the license in various countries to sell the Drug Dolenio in those countries.

Marketing Development expenses - "Dolenio" - These are expenses incurred abroad markets for Developing market for the Product Dolenio.,”

5. The Ld.DR on the contrary, argued that these payments have brought in enduring benefit to assessee and therefore cannot be treated to be revenue expenditure. He relied on the order passed by the Ld.AO.

We have perused the submissions advanced by both sides in light of records placed before us.

6. We note that the Ld.CIT(A) observed and held as under:

“On Examining the taxpayer submission on product registration expenses details & ledger account, the product registration expenses were categorised into mainly 3 heads. They are:

- 1. Patent / Trademark expense*
- 2. Variation in drug Expenses*
- 3. Annual/ Renewal fee*

Discussed in detail as follows:

- 1. Patent/Trademark expense :From the list of expenses it is noted that from sl.no 3-6 for A.Y 2012-13 &from sl.no.11-15 for A.Y 2013-14 are Patent/ trade mark*

related expenses. These expenses are related to registration of patent and trade mark, relevant taxes on registered patent/trademark. These expenses have enduring benefit for more than one year. The Patent / trade mark registered is intangible asset of the company. Registration expenses of the product/patent and relevant taxes paid on that patent is capital nature. The trademark expenses are mainly for registration of trade mark & its promotion. Marketing for trade mark is shown as marketing but on examining the bills & other documents it was observed those are Trademark registration expenses for different drugs .Even though if it is for marketing on the patent product, this expenses increasing the value of trade mark, which gives enduring benefit for morethan one year.

Hence, expenses related to Patent & trademark are creating intangible asset & capital in nature.

2. *Variation in drug Expenses :Expenses like Mutual Recognition Variation expenses /MRP Variation as mentioned in S.No 2 for A.Y 2011-12 & sl.No.8-10 for A 2012-13 are fees paid only when there is a variation in the registered product. These expenses were incurred only when there was variation from the registered patent. This variation may be on content of the drug or the raw material or the outlook of the drug or its Package. Examining the invoice & other evidence, it is noticed that taxpayer has submitted few evidence like formA2 & other forms ,which are country specific .These forms are to, inform the relevant regulatory bodies about the variation in the product registered . This fee is paid only when there is variation from registered product .This variation may not happen every year. The fee has been paid only when there was variation on the product registered. If there is no variation from the registered product ,than, there no need of payment of these fee. From this it very clear that these expenses are not incurring every year and these are not annual fee collected by Drug regulatory bodies across the globe. These are expenses incurred for the increasing/sustain the value of intangible asset i.e. patent registered. It means,these expenses were linked to the patent registered and having enduring benefit, considered Capital in nature.*
3. *Annual/Renewal fee: Paid for renewal of licence to market the drug. If it is annual fee than expenses should be same or increasing from year to year .As observed from evidence submitted before AO, it is*

confirmed that taxpayer was exploring into new market every year and incurred expense for registration of patent & trade mark. In that scenario, Annual fee cannot be reduced from Rs. 23,41,046 for A.Y 2011-12 to Rs. 4,32,597/- for A.Y 2012-13. When same was questioned representative confirmed that these expense are country specific and few countries it is paid every year and few countries paid for more than one year. In this regard, taxpayer was asked to furnish details on break up of payment of annual fee for country wise by 9.10.2018. But taxpayer has not furnished the details. Hence, it is not clear whether annual fee paid is incurred every year or fee may be for more than one year. If taxpayer furnish country wise details, than it is easy to find out actual amount incurred annually and same may be allowed as revenue expenses and remaining amount as capital expenditure.

A. Disallowance u/s 14A r w. Rule 8D: Taxpayer has not furnished any new evidence before AO. Hence, AO comments in the order hold correct and objection may be rejected.

As discussed above, taxpayer objection may not be accepted. However, decision may be taken based on merit of the case."

5.2 In the light of the comments in the Remand Report, the matter was reexamined and the appellant was given a copy of it to facilitate filing a rejoinder. The appellant reiterated its submission that the said expenditure being revenue in nature should be allowed.

5.3 Having considered the findings of the AO and the rejoinder, I have yenned the facts and found that the appellant has debited Rs. 1,71,71,503 as product registration expenses. During the course of the assessment, after obtaining details, the AO has capitalised the same and has allowed depreciation at the rate of 25°/0 on the same. In this segment of Pharma industry the invention becomes an asset and a property right enforceable in the court of Law only if the underlying invention (product /process) is registered in a particular country by the competent authority. Otherwise, the product developed loses its property rights in due course. Thus, to protect the rights, the innovation in the form of an Intellectual Property is registered locally in a particular regime. In the eyes of law, it is common asset if due process is not followed. Therefore, the expenses incurred to create such a property right assumes the character of it being incurred prior to asset coming into existence in that regime. Accordingly, these expenses can be considered as

part of the creation of the asset and hence treated as capital.

5.4 The expenditure claimed by the appellant under product registration charges, is further incurred under various heads, as reported by the AO in the Remand Report (supra).

5.5 Further, in this regard, it has been brought to my notice that the DRP, while disposing off the petition filed by the appellant for the Asst. Year 2014-15 in File No. 08/DRP-112018-19, have held as under:

"2.12.4 Having considered the submissions, and on perusal of the details filed, we note that the expenses incurred at SI. No. 1 to 4 i.e., "Annual fee, License Renewal fee, MRP variation, Mutual Recognition, Variation expenses"- pertain to expenses incurred for renewing the existing licences, variation in the already granted licenses and are in nature of revenue expenses allowable under Section 37 of the IT Act. Accordingly, the AO is directed to allow these expenses aggregating to Rs. 58,75,290. We also note that the expenses incurred at SI. No. 9, 10 and 11 are not incurred year on year. The expenditure at item No. 9 pertain to registration for the license of the Product Dolenio 1500 Mg at China, a new first time registration. Similarly, the expenditure at SI. No. 10 and 11 are first time registration expenses for grant of license for the products Cynocobalamin and Calcium Carbonate in UK. These are expenses incurred for grant of licenses and are capital in nature. They are not yearly expenses as contended by the assessee. We note that these expenses related to registration of a new product in these countries, leading to creation of fresh source of income for the assessee, and have an enduring benefit to the assessee. Therefore, these expenses aggregating to Rs. 68,35,794 are capital in nature, and therefore, the corresponding disallowance made by the AO is upheld. We note that the expenses incurred at SI. No. 7 and 8 are expenses incurred for obtaining license for products in Philliphines, UAE and the expenses in SI. No. 6, 6 and 12 are towards professional and other expenses incurred towards patents and trademarks registration which are definitely capital in nature. Accordingly, disallowance to the tune of Rs. 1,03,06,348 is upheld."

5.6 The said expenditure was incurred under different sub-heads, as reported by the AO in the Remand Report (supra). In the light of the above analogy, the items that mentioned in Sl.No. 1 and 2 being Annual Fee (licence renewal fee), mutual recognition variation (MRP)

expenditure of Rs. 432,597 and Rs. 12,543,851 respectively are treated as revenue expenditure incurred annually, while treating the remaining (items 3 to 6) as capital expenditure, which being patent expenses, registration expenses and trade mark expenses, and are definitely one time expenses related to the Intellectual Property being created in a particular foreign country. In the light of the above, I allow the expenditure at SI. No. 1 and 2 being the licence renewal fee, mutual recognition variation expenditure of Rs. 4,32,597 and Rs. 1,25,43,851 as revenue expenditure while treating the remaining as capital expenditure. Accordingly, the OA is directed to allow the expenditure to the extent of Rs. 1,29,76,448 out of total amount disputed in this appeal.”

7. The admitted factual position is that the assessee is manufacturing pharmaceutical products. Those products have been branded with their distinctive trademarks. By the registration of the product the assessee has safeguard against infringement of its patent. By the registration of trademark and patent the assessee has exclusive right of use. By incurring the said expenditure the assessee has protection of its running business, It is argued that patent is a set of exclusive rights granted by a state to an inventor for a limited period of time for a public disclosure of an invention. The exclusive right granted to a patentee in most countries is the right to prevent others from making or using the patented invention without permission. The expenses incurred by us for carrying out various patent registration formalities including statutory fees prescribed in different countries are duly reflected in the copy of accounts, as above. All that the registration of patents did was to enable the Assessee Company to obtain a speedy and less expensive remedy against the infringement of the patent rights. It gives benefit of exclusive right to use its patents. It is incurred for protection of the business of the company. It is thus, incurred wholly and

exclusively for the purposes of the Assessee Company's business allowable u/s 37(1) of the Act. Reliance is placed on following decisions:

Decision of Hon'ble Supreme Court in case of CIT v. Finlay Mills Ltd. reported in (1951) 20 ITR 475

Decision of Hon'ble Bombay High Court in case of CIT v. Century Spg., Wvg., & Mfg. Co. Ltd. reported in (1947) 15 ITR 105

8. It is stated that a pharmaceutical company can sell its product only after obtaining registration and that the expenditure was incurred for the running of the business therefore revenue in nature and is allowable under section 37(1) of the Act. Reliance is placed on following decisions:

- *Decision of Hon'ble Ahmedabad Tribunal in case of ACIT vs. CADilla Healthcare Ltd., reported in (2012) 21 taxmann.com 483, which stands affirmed by Hon'ble Gujrat High Court in Tax appeal No. 752 of 2012 by order dated 20/03/2013.*
- *Decision of Hon'ble Gujrat High Court in case of PCIT vs. Zydus Wellness Ltd reported in (2017) 81 taxmann.com 159.*

We have noted that for pharmaceutical product the assessee is required to obtain a registration from government drug regulatory authority. We have been informed that the assessee company has obtained its various products registered in other countries. We have also been informed that the pharmaceutical products have also been registered by the local authorities as also the medical associations situated in India. About trademark and patent registration, the admitted factual position is that the assessee is manufacturing pharmaceutical products. Those products have

been branded with their distinctive trademarks. By the registration of the product the assessee has safeguard against infringement of its patent. By the registration of trademark and patent the assessee has exclusive right of use. By incurring the said expenditure the assessee has protection of its running business. With this factual background we have examined the case laws cited by both the sides. It is submitted that the assessee has not obtained any new product or acquired any new trademark or acquired any new patent rights. The products were stated to be in existence and nothing new has been acquired or purchased by the assessee. In respect of this submission, the revenue has not placed any thing contrary.

It is an admitted fact that the assessee was already in the business of manufacturing of pharmaceutical products, and that the assessee also carries on scientific research work. For the protection of the result of the research the assessee has to get the patent registered. Enduring benefit is not the only criteria. An enduring benefit has to be coupled with the acquisition of an asset. There is nothing on record placed by the revenue to establish that there was a new product that was patented or in respect of which trade mark was registered by assessee during the years under consideration.

9. On perusal of ledger accounts placed at page 110 to 242 reveals that payments have been made to statutory bodies either for approval or as statutory maintenance in foreign nations. Assessee has also made payments being annual fees to the Medical agencies in foreign nations. All these are recurring in

nature. We are thus of the opinion that these payments are inextricably linked to the business of the assessee.

Hon'ble Supreme Court in the case of *Finlay Mills Ltd.* (*supra*) opined as under:

The contention of the revenue was fallacious. The machinery which acquires a greater productive capacity by reason of its improvement by inclusion of some new invention naturally becomes a new and altered asset by that process. So long as the machinery lasts, the improvement continues to the advantage of the owner of the machinery. The replacement of a dilapidated roof by a more substantial roof stands on the same footing. The result however of the Trade Marks Act is only two-fold. By registration, the owner is absolved from the obligation to prove his ownership of the trade mark. It is treated as prima facie proved on production of the registration certificate. It thus merely saves him the trouble of leading evidence, in the event of a suit, in a court of law, to prove his title to the trade mark. The registration is in the nature of collateral security furnishing the trader with a cheaper and more direct remedy against infringers. This is neither an asset nor an advantage so as to make payment for its registration a capital expenditure.

The advantage derived by the owner of the trade mark by registration falls within class of revenue expenditure. The fact that a trade mark after registration could be separately assigned, and not as a part of the goodwill of the business only, does not also make the expenditure for registration a capital expenditure. That is only an additional and incidental facility given to the owner of the trade mark. It adds nothing to the trade mark itself.

10. Hon'ble Supreme Court further observed as under:

*It was argued on behalf of the appellant that the question whether a certain disbursement was of a capital or revenue nature has to be decided according to the principle laid down in *British Insulated and Helsby Cables Ltd. v. Atherton* [1926] AC 205. In that case the company which carried on the business of manufacturers of insulated cables established a pension fund for its clerical and technical salaried staff. The fund was constituted by a trust deed which provided that members should contribute a percentage of their salaries to the fund and that the company should contribute an amount equal to half the contributions of the members; and further that the company should contribute a sum of £31,784 to form the nucleus of the fund and to provide the amount necessary in order that past years of service of the then existing staff should rank for pension. That sum was arrived at by an actuarial calculation on the basis that the sum would ultimately be exhausted when the object for which it was paid was attained. The House of Lords held that this payment was in the nature of capital expenditure and was therefore not an admissible deduction. Although in the opinions expressed by the different members of the House of Lords the line of approach is not completely the same, the principle stated by Lord Cave in his speech has been accepted as a safe test to distinguish capital expenditure from revenue expenditure. It was recognised*

that a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of business, may yet be expended wholly and exclusively for the purposes of the trade. The Lord Chancellor observed that the question appeared to be a question of fact which was proper to be decided by the Commissioners upon the evidence brought before them in each case. The test that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing that is going to recur every year was considered an useful element in arriving at the decision but was not certainly the decisive fact. The Lord Chancellor observed as follows:—"But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason for treating such an expenditure as properly attributable not to revenue but to capital".

In respect of Patent expenditure, it is submitted that assessee has to get the patent registered in various regions in order to safeguard its product from any infringement. Further nothing has been placed on record to establish that the patent expenditure has been incurred by assessee on a new product. One aspect cannot be ignored that assessee incurs these expenses every year.

11. Coming to the expensed incurred by assessee in respect of the drug called 'Dolenio', we note that it is sold by assessee in many countries. It is submitted that the original drug is of the same chemical composition which when manufactured for the first time was patented has been capitalized. It is submitted that any minute change from the original form of appearance needs to be approved by the Drug authorities of the foreign country where it is sold. The expenses incurred by assessee towards Mutual recognition process variation is necessary based on any change in the packing of the drug like change in color etc., or shape of the drug, or even the change of supplier.

In our opinion, the expenses incurred by assessee in respect of Dolenio during the years under consideration towards Mutual

recognition process variation, Patent and Trade mark and other registration expenses, are be considered as revenue expenditure, allowable under section 37(1) of the Act.

In respect of the Annual fee/license fees paid the ledger account reveals that these are recurring in nature, and hence cannot be treated to be one time payment. These are in respect of renewal of licence with the drug authorities in respective countries to continue to hold the licence to export and sell the products developed by assessee. Accordingly we do not find any infirmity in the observation of Ld.CIT(A) to treat the payments to be revenue expenditure allowable under section 37(1) of the Act.

Accordingly, we allow the grounds raised by assessee and dismiss the grounds raised by revenue for both the assessment years.

12. Next issue is raised by Revenue in **Ground no.4** for both the years under consideration.

Revenue is alleged with the action of the Ld.CIT(A) in deleting the disallowance under section 14A read with Rule 8 D(2) (ii) of the Act.

In the course of assessment proceedings, the Assessing Officer noted that the assessee has earned dividend income of Rs.3,14,10,280 which has been claimed as exempt under section 10(34) of the Act. The assessee had added back an amount of Rs.22,94,435, being 0.5% of the average value of the investment, as disallowance towards expenditure for earning exempt income as per clause (iii) of sub-Rule (2) of Rule 8D of the IT Rules, 1962. The Assessing Officer, however, made

disallowance of further amount of Rs.1,39,55,097 towards interest expenditure to be disallowed under Rule 8D,

On appeal, before the Ld. CIT(A), the addition made by the Ld.AO was deleted by observing as under:

“6.1 Further, in the context of the disallowance u/s 14A in respect of which the appellant submitted that it had disallowed voluntarily Rs. 118,52,411 under Rule 8D(2)(iii) and in addition the AO has disallowed an amount of Rs. 14,85,109 under Rule 8D(2)(ii) of the Act. In the light of the above submissions, the appellant has stated that only long term loans are vehicle loans and short term loan is working capital loans. Apart from this, it is observed from the Annual Balance Sheet. that there are no borrowings. Further, it was suggested that share capital and Reserve, and surplus of the company as on 31.03.2012 is Rs. 129.35 crores as against the overall investments of Rs. 34.27 crore in Mutual funds, which sufficiently explain the sources for the investments made by the appellant. In view of the above, I am of the view that considering the sources in the hands of the appellant, no disallowance under Rule 8D(2)(ii), is called for. In the result, the disallowance of Rs.14,85,109 made by the AO is deleted.

6.2 As regards the disallowance under Rule 8D(2)(iii), the appellant has stated that it has already voluntarily disallowed an amount of Rs. 118,52,411 being 0.5% of the investment on its own. However, this disallowance made under Rule 8D(2)(iii), which is a sort of compulsory disallowance, the same is confirmed. The AO is directed to verify the said fact and delete the disallowance additionally made under Rule 8D(2)(ii).”

The Ld.DR relied on order passed by Ld.AO.

13. The Ld AR submitted that the nature of dividend, was from investment in Mutual Funds (MFs) and that the investment was made out of surplus funds and funds from other sources and that no part of the borrowed funds was utilised for making the investment in MFs.

The Ld.AR also submitted as under:

“BLSPL filed an appeal with the CIT(A) against this disallowance. BLSPL vide letter dated 11.05.2018 [PB Pg 101] submitted that: -

- *Long-term borrowing is a vehicle loan and short-term borrowings are related to export receipts. Thus, interest paid is identifiable with specific borrowings.*
- *The total of capital and reserve exceed the investments made.*
- *The investments are made out of capital and reserves and not out of borrowings.*
- *In the absence of expenditure, no disallowance can be made under section 14A”.*

We have perused the submissions advanced by both sides in light of records placed before us.

14. The balance sheet for assessment year 2012-13 at page 6 of paper book reveals that assessee had share capital and reserve & Surplus totaling to Rs.1,29,35,94,928 and for assessment year 2013-14 the share capital and reserve & Surplus totaling to Rs.1,21,85,03,570/- It is noted that the total investment made by assessee for the years under consideration totaled to Rs.34.27 crores and 32.95 crores respectively. Assessee during the years had *suo moto* disallowed Rs.1,18,52,411/- and Rs.16,80,670/- under Rule 8 D(2)(iii). If there be interest-free funds available to an assessee sufficient to meet its investments and at the same time the assessee had raised a loan it can be presumed that the investments were from the interest-free funds available. However this needs verification as on the date of investment. The cash flow statement would disclose as on the date of making investments, which had given rise to the exempted income, that the assessee had interest free funds available with it. In the interest of justice and equity, we deed it fit to remand the case to the Assessing Officer for fresh consideration. The Ld.AO shall

afford reasonable opportunity of being heard to the assessee. The assessee shall prove its case that it is having interest free funds for making investments, by furnishing cash flow state for the respective assessment years.

Accordingly, the grounds raised by revenue stands allowed for statistical purposes in both the years under consideration.

In the result appeals filed by assessee stands allowed and appeals filed by revenue stands partly allowed for assessment years 2012-13 & 2013-14.

Order pronounced in the open court on 30th December, 2021.

Sd/-
(CHANDRA POOJARI)
Accountant Member

Sd/-
(BEENA PILLAI)
Judicial Member

Bangalore,
Dated, the 30th December, 2021.
/MS /

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

By order

Assistant Registrar,
ITAT, Bangalore