

**IN THE INCOME TAX APPELLATE TRIBUNAL
"E" BENCH, MUMBAI**

**BEFORE SHRI ABY T. VARKEY, HON'BLE JUDICIAL MEMBER AND
SHRI S. RIFAUR RAHMAN, HON'BLE ACCOUNTANT MEMBER**

ITA NO. 5115/MUM/2019 (A.Y: 2014-15)

Smita Conductors Pvt. Ltd., 1402/03 Raheja Centre Free Press Road Nariman Pont, Mumbai - 400021 PAN: AAACS5379K	v.	DCIT – 3(3)(2) Room No. 609, 6 th Floor Aayakar Bhavan, M.K. Road Mumbai - 400020
(Appellant)		(Respondent)

Assessee by	:	Shri Sunil Hirawat
Department by	:	Shri B.K. Bagchi
Date of Hearing	:	31.05.2022
Date of Pronouncement	:	21.06.2022

ORDER

PER S. RIFAUR RAHMAN (AM)

1. This appeal is filed by the assessee against order of the Learned Commissioner of Income Tax (Appeals)-8, Mumbai [hereinafter in short "Ld.CIT(A)"] dated 06.06.2019 for the A.Y.2014-15.
2. The only issue involved in this case is relating to disallowance u/s.14A of Income-tax Act, 1961 (in short "Act").

3. Brief facts of the case are, Assessing Officer observed that assessee has claimed dividend income of ₹.5,93,35,751/- and share of profit from partnership firm of ₹.3,62,017 as exempt from tax. He also observed that assessee has made suomoto disallowance of ₹.1,20,000/-. The Assessing Officer observed from the financial statements submitted by the assessee that the investment is increased from 2838.90 lacs to ₹.6543.38 lacs during this year and investment portfolio consists of investment in equity shares and investment in partnership and the income from these are not forming part of the total income. The Assessing Officer rejected the contention of the assessee that own funds were used for making the investment and proceeded to make the disallowance under Rule 8D(2)(ii) and 8D(2)(iii) of I.T.Rules and accordingly, he worked out the disallowance u/s. 14A of the Act to the extent of ₹.22,17,000/- and gave an adjustment of suomoto disallowance made by the assessee of ₹.1,20,000/-.

4. Aggrieved assessee preferred an appeal before the Ld.CIT(A) and before him assessee filed detailed submissions and for the sake of clarity it is reproduced below:-

"1.1. The appellant company is engaged in the business of manufacturing Aluminum Conductors (which are sold mainly to State Electricity Boards, Power Grid Corporation of India and other

Government and Semi-Government Organizations). During the assessment proceedings, the appellant has submitted the working of expenses incurred to earn the exempt income which has been computed by the appellant at Rs.1,84,490/- (Annexure A). As far as the share of income from the partnership firm is concerned, all the expenses pertaining to the earning of the said share income had been debited to the Books of Accounts of the partnership firm. All the investment in the units of Mutual Funds as well as in the shares of the companies (including the amount invested in partnership firm) had been made by the appellant out of its own funds and that no amount of borrowed funds had been utilized by the appellant company for the purpose of making investment in the units of Mutual Funds/shares of the companies as can be seen from the annual statements of accounts (Annexure B).

1.2 The LAO has ignored the submissions and calculation submitted by the assessee and proceeded to apply Rule 8D, without considering the fact that Rule 8D is to be applied only if the method adopted by the assessee is not satisfactory. In the impugned assessment order, the LAO has completely ignored the claim by the appellant of Rs.1,84,490/- which is based on the estimated cost of the man hours to look after the investments, the income of which is claimed exempt from tax. Further, an equal amount of the direct cost is also considered for the purpose of disallowance u/s.14A. The LAO has rejected the working of appellant by simply stating that the disallowance is not as per Rule 8D.

1.3 The LAO has invoked rule 8D of the I.T. Rules without recording his Satisfaction as stipulated in sub section 2 of section 14A of the IT. Act. Furthermore the appellant submit that AO is not justified in considering the total investment, rather than only investments on which dividend has been received, while working the disallowance u/s 14A r.w.rule 8D of the I.T. Rules. The Appellant submits that the administrative expenses and interest expenses were incurred by the Appellant Company for carrying out its business activity and no part of the expenses can be considered as relatable to earning of exempted income. There is no direct nexus between the exempted income earned and expenses incurred by the Appellant. The Appellant submits that the Hon'ble Bombay High Court in the Case of Godrej & Boyce Mfg Co. Ltd. Vs. DCIT [328 ITR 81] has clearly held that Rule 8D should be invoked only as an exercise of the last resort i.e. when the working of the disallowance u/s.14A is not possible from the state of accounts maintained by the assessee. In short, where the accounts of the assessee are reliable and having regard to such accounts, the disallowance u/s.14A can be worked out by any scientific accounting method, then the same must be accepted. Rule 8D should not be resorted to in such a case.

This is so even if the AO is not satisfied with the method or manner in which the assessee has worked out the disallowance. In such a case, it is open to the AO to work out the disallowance on the basis of any other alternative scientific method based on the accounts of the assessee. Thus Rule 8D is an exercise reserved for the last resort. Unless the accounts of the assessee are simply so unreliable that the disallowance cannot be worked out at all, this Rule must not be invoked.

1.4 This principle should be also clear from a reading of the provisions of both sections 14A as well as Rule 8D. Sub-section [2] of section 14A mandates that the power of the Assessing Officer to determine the disallowance in accordance with Rule 8D is circumscribed by a pre-condition that the claim of the assessee regarding disallowance u/s.14A is not satisfactory 'having regards to the accounts' of the assessee. The language in sub-rule [1] of Rule 8D is a near mirror image of the language used in section 14A [2]. Here too, it is clarified that in the first place, the LAO must ensure that the disallowance is worked out 'having regards to the accounts of the assessee'. In Appellant's case, the accounts are reliably maintained, and regularly audited for its reliability. These accounts are capable of generating details of the expenditure relevant for earning exempt income.

Any disallowance under section 14A must therefore be worked out in terms of these accounts and not by applying the provisions of Rule 8D [2].

1.5 The LAO has not expressed any dissatisfaction on the calculation submitted by the assessee. It has not been shown by the LAO that any expenditure had been incurred by the assessee for earning its dividend income. As such, Rule 8D was not appropriately applied by the LAO. The onus was on the LAO to establish any such expenditure. This onus has not been discharged. "In "CIT v. Hero Cycles" (P&H) 323 ITR 518, under similar circumstances, it was held that the disallowance u/s 14A of the Act requires a clear finding of incurring of expenditure and that no disallowance can be made on the basis of presumptions. In "ACIT v. Eicher Ltd." 101 TTJ (Del)369, it was held that the burden is on the LAO to establish nexus of expenses incurred with the earning of exempt income before making any disallowance u/s 14A of the Act. In "Maruti Udyog v. DCIT' 92 ITD 119(Del), it has been held that before making any disallowance u/s 14A of the Act, the onus to establish the nexus of the same with the exempt income, is on the revenue."

1.6. The LAO has adopted an incorrect course, since he has not considered the assessee's claim at all. In this connection, we rely upon the decision of the ITAT Mumbai Bench in the case of Auchtel

Products Ltd Vs ACIT in ITA No 3185/Mum/2011 (Asstt. Year 2008-09) wherein it was held the further disallowance u/s 14A is called for when the AO is not satisfied with the assessee's claim of having incurred no expenditure or some amount of expenditure in relation to exempt income. Satisfaction of the AO as to the incorrect claim made by the assessee in this regard is sine qua non for invoking the applicability of Rule 8 D. Such satisfaction can be reached and recorded only when the claim of the assessee is verified. If the assessee proves before the AO that it incurred a particular expenditure in respect of earning the exempt income and the AO gets satisfied, then there is no requirement to still proceed with the computation of amount disallowable as per Rule 8D. From the assessment order, it is observed that the AO simply kept the assessee's submissions on record without appreciating as to whether these were correct or not. He proceeded on the premise as if the disallowance as per Rule 8D is automatic irrespective of the genuineness of the assessee's claim in respect of expenses incurred in relation to exempt income. It is an incorrect course adopted by the AO. The correct sequence, in our considered opinion, for making any disallowance u/s 14A is to, firstly, examine the assessee's claim of having incurred some expenditure or no expenditure in relation to exempt income. If the AO gets satisfied with the same, then there is no need to compute disallowance as per Rule 8D. It is only when the AO is not satisfied with the correctness of the claim of the assessee in respect of such expenditure or no expenditure having been incurred in relation to exempt income, that the mandate of Rule 8D will operate. In the instant case, the authorities below have directly gone to the second stage of computing disallowance u/s 14A as per Rule 8D without rendering an opinion on the correctness or otherwise of the assessee's claim in this regard."

1.7 In this connection, we also rely upon the following decisions wherein it has been held that no satisfaction recorded by the Assessing Officer before invoking Rule 8D.

- *Dy. CIT v. REI Agro Ltd. (ITA No.1811/Kol/201 2)*
- *CIT v. REL Agro Ltd. (Calcutta High Court)*
- *M/s. Global Calcium Pvt. Ltd. (ITA No.2255/Mds/2013)*
- *Kalyani Steels Ltd. v. Addl. CIT (ITA No.1733/PN/2012)*
- *3DPLM Software Solutions Ltd. v. ITO (ITA No.5736/Mum/2012)*

1.8 In view of the above, it is submitted that applying Rule 8D without rejecting the claim of the appellant is erroneous and

accordingly, the assessment order should be annulled on this Ground alone.

SUBMISSIONS:

2.1 The LAO has made the disallowance of Rs.22,17,000/- in the impugned assessment order being 12% of the average investment held by the appellant.

2.2 With regard to the disallowance of Rs.22,17,000/- being 12% of investment under Rule 8D(2)(iii), the LAO was explained that the disallowance u/s.14A, Rs.1,84,490/- is the amount which is to be disallowed ae 14A and a statement to this effect was submitted vide letter dated 12.08.2016 (Annexure-A). The said statement is based on the estimated cost of the man hours to look after the investments, the income of which is claimed exempt from tax. Further, an equal amount of the administrative cost is also considered for the purpose of disallowance u/s.14A. As such, it is submitted that Rule 8D should not be made applicable to the case of the assessee in view of the provisions of Section 14A of the Income-tax Act and the LAO may kindly be directed to restrict the disallowance at Rs.1,84,490/- u/s.14A.

2.3 In this connection, we would like to submit that similar working of the appellant based on the man hours plus administrative expenses has been rejected by the Assessing Officers since Asstt. Year 2008-09. In the Asstt. Year 2008-09, Rule 8D was first made applicable. Against the application of Rule 8D in Asstt. Year 2008-09 by the LAO, the appellant had filed appeal before the learned CIT(A). Against the order of the learned CIT(A), the appellant had filed appeal before ITAT. ITAT in its order in ITA No.158/Mum/2013 of Asstt. Year 2008-09 (copy enclosed — Annexure-C) restricted the disallowance of expenses at Rs.25,000/- instead of Rs.6,01,991/calculated by the LAO under Rule 8D(iii) stating as under.

"4. We have considered the rival contention of the parties and gone through the orders of authorities below. We have noticed that the assessee earned dividend income of Rs.2,03,22,503/- and profit from partnership of Rs.14,186/- which were claimed exempted by the assessee. The AO asked the assessee fo furnish the details of the expenses incurred for earning exempt income. The assessee furnished its explanation alongwith the details of exempt income, profit and loss account and the balance sheet. The AO has not discussed in his order about the statement of account and the details of expenses incurred by the assessee, which was furnished before him during the assessment proceedings. The

AO has not rejected the accounts filed by the assessee. The AO invoked the provision of rule 8D for making disallowance u/s.14A. The AO disallowed Rs.26,82,784/- under rule 8D(ii) and Rs.6,01,991/ under rule 8D(iii). We have seen that assessee was having sufficient interest on the free fund available. The assessee had a reserve and surplus fund of Rs.28,42,58,814/ as on 31% March 2008. The assessee made the investment of Rs.17,01,81,310/ in mutual funds during the year under consideration. Thus, keeping in view the fact and circumstances of the case, we deem it appropriate that a lump sum disallowance of Rs.25,000/under section 14A would meet the end of justice. Hence the AO is directed to restrict the disallowance under section 14A to Rs.25,000/-. In the result this ground of appeal is partly allowed."

2.4 The LAO has made the disallowance as per Rule 8D by ignoring the working as discussed in para-2.2 above even in Asstt. Year 2012-13, ignoring the working based on the man hours plus administrative expenses. Against the order of the LAO, the appellant has filed appeal before the learned CIT(A). The learned CIT(A) in his order in appeal No. CIT(A)-8/IT-743/14-15 dated 29.02.2016 relating to the Asstt. Year 2012-13 (copy enclosed - Annexure-D) has accepted the working based on the man hours and administrative expenses and held as under:

"5.1.4 In the instant case, I find that the Assessing Officer has not given any justification for rejecting the claim of the appellant that no expenditure was incurred in earning of dividend income nor has he given any specific reasons for rejecting the computation of indirect expenses as submitted by the appellant. He has also not taken into consideration the fact that the appellant's own funds by way of capital and reserves were more than the investments made. In a recent order of Hon'ble Bombay High Court in HDFC Bank Ltd. vs. DCIT, Writ Petition No.1753 of 2016 dated 25.02.2016, the Hon'ble Court has emphatically reiterated its earlier decision in CIT vs. HDFC Bank Ltd. 366 /TR 505. Therefore, in view of the facts and circumstances of the case and the ratio of various judicial pronouncements as mentioned above the Assessing Officer is directed to accept suo moto disallowance of Rs. 3,94,092/made by the appellant under section 14A and the balance disallowance id deleted. These grounds of appeal are therefore allowed."

2.5 Against the order of the learned CIT(A), the Department has filed appeal before ITAT and the ITAT in its order in ITA

No.3678/Mum/2016 dated 26.02.2018 has upheld the order of the learned CIT(A) (copy enclosed — Annexure-E) stating as under:

"4. The facts and circumstances during the year under consideration are Same and the CIT(A) has restricted the disallowance to the extent of Rs.3,94,092/- whereas disallowance upheld by the Tribunal in A. Y. 2008-09 was ₹.25,000/-. We do not find any reason to interfere in the order of the CIT(A)."

2.6 In view of the above facts and circumstances as well as the judicial pronouncements in the case of the appellant, it is submitted that the disallowance u/s.14A in respect of expenses attributable to the income exempt from tax should be restricted to Rs.1,84,490/- as per the statement submitted before the LAO which has been upheld by the learned CIT(A) as well as ITAT in earlier Asstt. Years."

5. After considering the detailed submissions of the assessee Ld.CIT(A)

rejected the submissions and dismissed the ground filed by the assessee

with the following observation: -

"3.1.5 In view of the above detailed discussion of Hon'ble SC order in Maxopp Investments Ltd, it is held here that the total disallowance u/s 14A in this case cannot be the total exempt income earned by the appellant company. However, the total exempt income earned by the appellant company is Rs 5,93,95,751/- which is much more than the disallowance made by the AO. Keeping in view the entire facts and circumstances of the case and after considering all the arguments put forward by the appellant, this case is considered to be a fit case for invoking the provisions of section 14A. The Hon'ble ITAT, Amritsar Bench, Amritsar in a recent judgement in the case of Lally Motors Pvt Ltd has held that after passing of the Apex Court decision in the case of Maxopp Investments Ltd, the entire provisions of section 14A have become a procedural law which get triggered off the moment certain elements are present. In a similar way, the case of the appellant gets hit by the provisions of section 14A rwr 8D, which cannot be helped. These grounds are dismissed."

6. Ld.CIT(A) also dismissed and sustained the adjustment made on the disallowance u/s. 14A of the Act while computing the book profits u/s.115JB of the Act.

7. Aggrieved assessee is in appeal before us raising following grounds in its appeal: -

"1. On facts and in law, the learned Commissioner of Income-tax (Appeals) (hereinafter referred to as the "Ld. CIT(A)") had failed to appreciate that the learned Assessing Officer [LAO) had applied Rule 8D without rejecting the claim of the appellant. Under the facts and circumstances of the matter, he ought to have restricted the disallowance u/s.14A to the amount disallowed by the appellant.

(i) On facts and in law, the Ld. CIT(A) had erred in confirming the disallowance of Rs.22,17,000/-, in place of Rs.1,84,490/- disallowed by the appellant. Under the facts and circumstances of the matter, he ought to have restricted the disallowance U/s.14A to Rs.1,84,490/-.

(ii) On facts and in law, the Ld. CIT(A) had erred in not following the decision of Hon'ble ITAT in the case of appellant without appreciating the fact that under similar facts and circumstances the ITAT has upheld the disallowance u/s.14A as per the working of the appellant.

(iii) On facts and in law, the Ld. CIT(A) had erred in not appreciating the fact that the ratio of the decision of the Hon'ble Supreme Court in the case of Maxopp Investment Ltd. Vs. CIT (2018) 91 Taxman.com 154 (SC) is not applicable to the facts of the case of the appellant.

3. On facts and in law, the Ld. CIT(A) had erred in confirming the disallowance of Rs.22,17,000/- u/s.14A made by the LAO while computing the Book Profit u/s.115JB in place of Rs.1,84,490/-. Under the facts and circumstances of the matter, he ought to have restricted the disallowance to Rs.1,84,490/-.

4 The Appellant craves leave to add, alter, vary, omit, substitute or amend the above grounds of appeal, at any time before or at, the time of hearing of the appeal, so as to enable the Hon. ITAT to decide this appeal according to law."

8. At the time of hearing, Ld. AR brought to our notice expenses incurred and allocated by the assessee to the exempt income earned by the assessee to the extent of ₹.1,84,490/- which is placed in Paper Book filed by the assessee. Further, he brought to our notice Page No. 22 of the Paper Book to submit the availability of own funds from A.Y. 2008-09 to current assessment year. He highlighted that assessee has substantial own funds for making investments and he prayed that the issue may be remitted back to the file of the Assessing Officer to verify the facts on record.

9. On the other hand, Ld. DR relied on the findings of the Ld.CIT(A).

10. Considered the rival submissions and material placed on record, we observe from the detailed statement of availability of the own funds and investments made by the assessee, from the above said statement, it is clear that assessee has consistently made the investments over the years and also assessee's own funds available in the business are much more than the investments made by the assessee. We noticed that Assessing

Officer has also made disallowance both under rule 8D(2)(ii) and 8D(2)(iii) of I.T. Rules. Therefore, for the sake of justice we are inclined to remit this issue back to the file of the Assessing Officer to redo the disallowance u/s. 14A after duly considering the materials brought on record by the assessee and the disallowance u/s. 14A may be determined as per law, after duly considering the fact that assessee has huge own funds available in the business. Needless to say that the Assessing Officer shall give adequate opportunity of being heard to the assessee. Accordingly, grounds raised by the assessee is allowed for statistical purpose.

11. In the result, appeal filed by the assessee is allowed for statistical purpose.

Order pronounced in the open court on 21st June, 2022.

Sd/-
(ABY T. VARKEY)
JUDICIAL MEMBER
Mumbai / Dated 21.06.2022
Giridhar, Sr.PS

Sd/-
(S. RIFAUH RAHMAN)
ACCOUNTANT MEMBER

Copy of the Order forwarded to:

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

//True Copy//

BY ORDER

(Asstt. Registrar)
ITAT, Mum