IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER
AND
SHRI SOUNDARARAJAN K., JUDICIAL MEMBER

ITA No. 1524/Bang/2024
Assessment year : 2015-16

Khim Engineering Industries Private Limited, A Block, Shivsagar Estate, Dr. A.B. Road, Worli, Mumbai – 400 018. **PAN : AAACB 7369N**	Vs.	The Income Tax Officer, Ward 4(1)(2), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Shri Ravindra T., CA
Respondent by	:	Shri Subramanian S., Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	17.10.2024
Date of Pronouncement	:	28.10.2024

O R D E R

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the order dated 28.06.2024 of the CIT(Appeals), National Faceless Appeal Centre, Delhi [NFAC], for the AY 2015-16.

2. Briefly stated the facts of the case are that the assessee filed return of income on 28.09.2015 declaring total income of Rs.1,03,45,480. The case was selected for scrutiny and statutory notices issued to the assessee. During the assessment proceedings, the AO noted that the assessee has reported 'Non-current Investments' of Rs.2,14,05,31,281in equity shares. The assessee has not claimed any expenditure on these investments and the provisions of section 14A are attracted. The assessee replied that it did not earn any exempt income and section 14A is not attracted and relied on the following judgments:-

- CIT v. Winsome Textile Industries [2009] 319 ITR 2014
- CIT v. Corrtech Energy Pvt. Ltd. [2014] 45 taxmann 116 (Guj)
- CIT v. Shivam Motors
- CIT v. Lakhani Marketing

3. The assessee further submitted that the question of disallowance of 0.5% of the investments does not arise since the company has advanced share application money during the earlier years and not in the current year as evident from Note No.8 of the financial statements and no expenditure whatsoever is incurred for these investments during the year.

4. The AO noted that language of sub-section (2) of s. 14A provides that provisions of sub-section (2) also apply in relation to case where assessee claims that no expenditure has been incurred during the year. In light of CBDT Circular No.5 of 2014, the AO made disallowance u/s. 14A r.w. Rule 8D(2) of Rs.1,07,02,656 and completed the assessment on 30.11.2017. Aggrieved from the above

order, the assessee filed appeal before the First Appellate Authority (FAA).

5. The ld. FAA issued 5 notices on different dates and assessee sought adjournment on 25.05.2024 and 12.06.2024 and thereafter there was no response from assessee's side. Accordingly he decided the issue on the basis of documents available before him and dismissed the appeal of the assessee. Aggrieved, the assessee is in appeal before the ITAT.

6. The ld. AR submitted that the AO has wrongly made addition u/s. 14A without recording satisfaction and not sustainable. This issue has been settled by various courts and Tribunals. He further submitted that during the year there was no any fresh investments made by the assessee and there was no exempt income earned. In this regard, he has filed financial statements, copy of return, computation of income and reiterated the submissions made before the AO.

7. The ld. DR relied on the order of lower authorities and submitted that disallowance u/s. 14A should be made even if there is no exempt income as per CBDT Circular No.5/2014.

8. Since the issue raised by the assesse in its grounds of appeal has been settled by the Hon'ble jurisdictional High Court and other various courts and the ITAT Benches of the Tribunal. The CIT (A) has not decided the issue on merits and facts are similar as per the following judicial precedents, therefore instead of sending back to the file to the

CIT(A) we are taking for decision. Considering the rival submissions, we note that assessee has raised ground No.1 that disallowance u/s. 14A r.w. Rule 8D without recording its satisfaction for not accepting the claim of the assessee. There is no proof submitted by the revenue side that the AO has recorded any satisfaction before disallowing u/s 14A of the Act, which is mandatory requirement for applying section 14A as decided by various Hon'ble Courts and ITAT Benches of the Tribunal. Recently the ITAT Raipur Bench after relying on various judgements has decided on similar issue in the case of SRS Investments (P) Ltd. Vs ITO in ITA No. 126/RPR/2024 order dated 22.05.2024 reported in [2024] 163 taxmann.com 480 (Raipur-Tribunal) in which it has been held as under :-

> **10.** I have thoughtfully considered the aforesaid contention of the Ld. AR and principally concurred with him that in case if the assessee has sufficient self-own funds, the presumption would be that the investment in the exempt income yielding investment was sourced out of the same. My aforesaid conviction is fortified by the judgment of the Hon'ble High Court of Bombay in the case of *CIT* v. *HDFC Bank Ltd.* . The Hon'ble High court had observed that where the assessee has more interest free funds than the tax-free investments, then a presumption would arise that tax free investments would be out of the interest-free funds. In fact, the aforesaid view is further supported by the judgment of the Hon'ble Supreme Court in the case of *South Indian Bank Ltd.* v. *CIT* , wherein the Hon'ble Apex Court had held that if investment in exempt income yielding shares is made out of common funds and the assessee had available non-interest bearing funds larger than the investments made in tax-free securities then in such cases, no disallowance u/s. 14A would be called for. Although, I am principally in agreement with the aforesaid contention of the Ld. AR but the said factual position, in all fairness, would be required to be verified. Accordingly, I restore the matter to the file of the A.O with a direction to verify the aforesaid factual position. In case, if the aforesaid claim of the assessee as regards the availability of the sufficient self-owned funds is found to be in order, then, no disallowance of any part of the interest expenditure u/s. 14A r.w.r. 8D would be warranted in its case. Accordingly, this part of the

ground is allowed for statistical purposes to the extent relevant in terms of my aforesaid observations.

11. Apropos the disallowance of administrative/other expenses u/s. 14A r.w.r. 8D(2)(*ii*), I finds substance in the claim of the Ld. AR that as the A.O had failed to record his dissatisfaction as regards the assessee's claim that no part of such expenditure claimed as deduction in the profit and loss account was attributable towards earning of the exempt income, therefore, he could not have mechanically worked out the disallowance to the said extent.

12. On a careful perusal of the assessment order, I find substance in the claim of the Ld. AR that the A.O had without dislodging the assessee's claim that no part of the administrative/other expenditure claimed as deduction in the profit and loss account was attributable to earning of the exempt income, and had mechanically worked out the disallowance u/s.14A of the Act as per the methodology contemplated under Rule 8D of the Income Tax Rules, 1962. Also, the CIT(Appeals), without correcting the aforesaid lapse of the A.O had merely approved his order. I find that a similar issue had been dealt with and adjudicated by the ITAT, Panaji Bench in the case of *Infrastructure Logistics (P.) Ltd.* (*supra*) wherein it was held that where the A.O made disallowance u/s. 14A r.w.r.8D, but had failed to record his dissatisfaction as regards the claim of the assessee that no part of expenditure claimed as deduction could be attributed towards earning of the exempt income, he had wrongly assumed jurisdiction u/s. 14A as a result whereof disallowance determined by him by triggering the mechanism contemplated in Rule 8D(2)(*iii*) could not be sustained and was liable to be vacated. For the sake of clarity, the relevant observations of the Tribunal are culled out as under:

"13. After giving a thoughtful consideration to the issue in hand in the backdrop of the aforesaid contentions advanced by the Ld. Authorized Representatives of both the parties, we find substantial force in the claim of the Ld. AR. Admittedly, pursuant to the judgment of the Hon'ble Supreme Court in the case of *Maxopp Investment Ltd.* v. *CIT, New Delhi* (2018) , the A.O prior to dislodging the disallowance, if any, offered by the assessee u/s.14A of the Act remains under a statutory obligation to record his dissatisfaction as regards the correctness of the said claim of the assessee in reference to its accounts and therein, categorically record the reasons as to why the claim of the assessee qua the disallowance so offered by him is not being accepted. On a similar footing would be a case where the assessee had not attributed any part of the expenditure for earning of exempt dividend income and, the A.O is not satisfied with the said claim. Apart from that we find that the Hon'ble Jurisdictional High Court in the case of CIT v. Sociedade De Fomento Industrial (P). Ltd (*supra*) had observed, that the A.O before rejecting the disallowance offered by the assessee remains under a statutory obligation to give a clear finding with reference to the

accounts of the assessee that the other expenditure which were being claimed qua the non-exempt income were in fact related to its exempt income. Also, as stated by the Ld. AR, and rightly so, a similar view had been taken by the Hon'ble High Court of Delhi in the case of *H.T Media Ltd*. v. *Pr. CIT* . Now, in the case before us, we find that the A.O had though deliberated at length on the scheme of section 14A of the Act, but had failed to give any reason as to why the claim of the assessee that no part of the expenditure could be attributed towards earning of exempt income was not to be accepted. Although, the CIT(Appeals) in his order had tried to improve upon the aforesaid lapse of the A.O, but a perusal of his observations too do not inspire much of confidence, as the statutory obligation requiring recording of a clear finding with reference to the assessee's accounts that the expenditure claimed by the assessee to have been incurred in respect of its non-exempt income was in fact related to its exempt income, is not found to be satisfied. Although the CIT(Appeals) had referred to the assessee's claim for deduction of certain expenses, but the same are more or less in the nature of general observations which would not suffice the satisfaction of the obligation that is cast upon the revenue for dislodging the claim of the assessee qua attribution of any part of the expenditure for earning of exempt dividend income. Be that as it may, we, in terms of our aforesaid observations, concur with the claim of the Ld. AR that as the A.O had failed to record his dissatisfaction as regards the claim of the assessee that no part of the expenditure claimed as deduction could be attributed towards earning of exempt dividend income, therefore, he had wrongly assumed jurisdiction u/s.14A of the Act, as a result whereof the disallowance of Rs. 15,03,242/-determined by him by triggering the mechanism contemplated in Rule 8D(2)(*iii*) cannot be sustained and is liable to be vacated. As we have vacated the disallowance made by the A.O u/s.14A(2)(*iii*) for want of valid jurisdiction on his part, therefore, we refrain from adverting to the other contentions that have been advanced by the Ld. AR qua sustainability of the said disallowance on merits which are left open. Thus, the Ground of appeal No.2 raised by the assessee is allowed in terms of our aforesaid observations.

13. Also, I find that the Hon'ble Supreme Court in the case of *Maxopp Investment Ltd.* v. *CIT* has held that that if the A.O was not satisfied with the disallowance that was offered by the assessee, then, he remained under a statutory obligation to record his dissatisfaction to the said effect, as it was only thereafter that he could assume jurisdiction and take recourse to and work out the disallowance as per sub- section (2) and (3) of Sec. 14A of the Act.

14. I further find that the Hon'ble Supreme Court in the case of *Godrej & Boyce Manufacturing Company Ltd.* v. *Dy. CIT* [2017] 81 taxmann.com 11/247 Taxman 361/394 ITR 449/[(Civil Appeal No. 7020 of 2011, dated

8-5-2017], dealing with the statutory requirement of satisfaction on the part of the A.O as regards not accepting the correctness of the claim of the assessee in respect of the expenses claimed by him to have been incurred in relation to income which does not form part of the total income of the assessee, had held as under:-

> "Sub-sections (2) and (3) of Section 14A of the Act read with Rule 8D of the Rules merely prescribe a formula for determination of expenditure incurred in relation to income which does not form part of the total income under the Act in a situation where the Assessing Officer is not satisfied with the claim of the assessee. Whether such determination is to be made on application of the formula prescribed under Rule 8D or in the best judgment of the Assessing Officer, what the law postulates is the requirement of a satisfaction in the Assessing Officer that having regard to the accounts of the assessee, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the assessee. It is only thereafter that the provisions of Section 14A(2) and (3) read with Rule 8D of the Rules or a best judgment determination, as earlier prevailing, would become applicable."

I am of the view that in the backdrop of the aforesaid judgment of the Hon'ble Supreme Court in the case of *Godrej & Boyce Manufacturing Company Ltd.* (*supra*), the issue as regards requirement of a satisfaction of the Assessing Officer that having regard to the accounts of the assessee, as placed before him, it is not possible to generate the requisite satisfaction with regard to the correctness of the claim of the assessee, is obligatory and cannot be dispensed with by the A.O, thus stands settled and is no more res integra. I, thus, in the backdrop of the aforesaid judgment of the Hon'ble Apex Court am of the considered view that now when the assessee company in the present case had claimed that no part of the administrative/other expenses claimed by it as a deduction were incurred in relation to the income which did not form part of its total income, then the A.O only after being satisfied that having regard to the accounts of the assessee, as placed before him, it was not possible for him to generate the requisite satisfaction with regard to the correctness of the claim of the assessee, thus, only after rejecting the said claim of the assessee, after complying with the aforesaid statutory obligation as stood cast upon him, could have validly proceeded with and determined the amount of such other/administrative expenditure incurred in relation to the income which did not form part of its total income. I however find that in the case of the present assessee company the A.O had carried out the disallowance of the other/administrative expenditure under Sec.14A in a mechanical manner as per the methodology provided in Rule 8D(2)(*ii*). I am of the considered view that the general observations of the A.O can by no means partake the

> color and character as that of a satisfaction, which as per the mandate of law is required to be arrived at by him with regard to the correctness of the claim of the assessee in respect of the administrative/other expenses claimed to have been incurred in respect of income which did not form part of the total income of the assessee company, having regard to the accounts of the assessee, as were placed before him. I, thus, being of the considered view that as the A.O had summarily carried out the disallowance of the administrative/other expenses under Sec. 14A, as per the methodology provided in Rule 8D(2)(*ii*), without satisfying the statutory requirement of first arriving at a satisfaction as required by the mandate of law, having regard to the accounts of the assessee as placed before him, therefore, am unable to persuade myself to uphold the disallowance of Rs.2,22,963/- which had been sustained by the CIT(A). The order of the CIT(A) sustaining the disallowance of Rs.2,22,963/- under Sec. 14A is thus set aside. Accordingly, this part of the ground is allowed to the extent relevant in terms of my aforesaid observations Respectfully following the above judgment, we allow the legal issue raised in ground No.1 raised by the assessee. Accordingly the other grounds are not considered for adjudication and are left open.

9. Respectfully following the above judgment, we allow the legal ground raised by the assessee.

10. On merits, further, we note that the AO has made disallowance u/s. 14A r.w. Rule 8D of Rs.1,07,02,656. We note from the financial statements that the total non-current investments in FY ending 31.03.2014 is at Rs.2,14,05,31,281 and the same amount remained as on 31.03.2015 which is evident from Schedule-8 of the financial statements. In the Profit & Loss account under the head income, there is revenue from operations of Rs.2.56 crores and under the head Other Income as per Note No.14, assessee has received interest income of Rs.36,49,742 and profit on sale of fixed assets is Rs.1,70,976 and there was no any exempt income shown in the financial statements. We also noted from ITR-6 filed by the assessee that there is no income reported under the Schedule Exempt Income. It clearly shows that there is no

exempt income earned by the assessee during the year. If there is no exempt income earned no disallowance should be made u/s 14A. A similar issue has been decided by the jurisdictional High Court in the case of Delhi International Airport Ltd. v. DCIT (2022) 138 taxmann.com 541 (Kar) dated 14.12.2021 wherein it is held as under:-

> **24.** These appeals have been admitted to consider the following substantial questions of law;
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> Common substantial question of law in all the appeals filed by the Revenue;
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> "1. Whether on the facts and in the circumstances of the case and in law, the Tribunal is right in law in remanding back the issue to assessing authority with a direction to allow the relief as the assessee do not have exempt income and as such no disallowance can be made under section 14A read with rule 8D of the Act contrary to provisions of section 14A and rule 8D and Circular No. 5 of 2014 dated 11-2-2014 which has clarified that rule 8D read with section 14A provides for disallowance of the expenditure even when the taxpayer in a particular year has not earned any exempt income?."
>
> Common substantial question of law in ITA.Nos.702/2018 and 701/2018;
>
> "Whether on the facts and in the circumstances of the case and in law, the Tribunal is right in law in setting aside the issue pertaining to disallowance made by assessing authority under section 40(*a*)(*ia*) by relying on Delhi High Court decision in case of Ansal Landmark Township Pvt. Ltd. which has been challenged by Revenue before Hon'ble Supreme Court in SLP No. 1248 of 2016 and even when the assessing authority has rightly made disallowance under said section has conditions set out in said provisions are fully satisfied to make such disallowance?"
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> Additional substantial question of law in ITA No. 702/2018;
>
> "Whether on the facts and in the circumstances of the case and in law, the Tribunal is right in law in deleting addition of income of Rs. 69,04,00,000/- by directing the assessing authority to allow it on cash basis which was made by assessing authority on accrual basis thereby recognizing mixed system of accounting for assessee-company which is not permissible as per the provisions of section 145 of the Act?."
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> **25.** Re: common substantial question of law No. 1:

The issue involved herein is squarely covered by the decision of the Coordinate Bench of this Court in the case of *CIT* v. *Quest Global Engineering Services (P.) Ltd.* [IT Appeal No. 133 of 2015, dated 15-2-2021]. Concurring with the same, we answer the said substantial question of law in favour of the assessee and against the Revenue.

11. Respectfully following the above judgments we allow the appeal of the assessee in above terms on merits also.

12. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 28th day of October, 2024.

Sd/-	Sd/-
(SOUNDARARAJAN K.)	(LAXMI PRASAD SAHU)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Bangalore,
Dated, the 28th October, 2024.

/*Desai S Murthy /*

Copy to:

1. Appellant 2. Respondent 3. Pr.CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.